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No. _____

In the Supreme Court of the United States

OCTOBER TERM, 1982

SOONER FEDERAL SAVINGS AND LOAN ASSOCIATION, KAY COUNTY FEDERAL SAVINGS AND LOAN ASSOCIATION, and FIRST FEDERAL SAVINGS AND LOAN ASSOCIATION OF LAWTON
Appellants

v.

OKLAHOMA TAX COMMISSION, and THE STATE OF OKLAHOMA
Appellees

ON APPEAL FROM THE SUPREME COURT OF THE STATE OF OKLAHOMA

JURISDICTIONAL STATEMENT

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PRELIMINARY MATTER

QUESTIONS PRESENTED

1. Did the Supreme Court of Oklahoma err in determining that 12 U.S.C. §1433 does not deprive the State of Oklahoma of the right to tax dividends disbursed by the Federal Home Loan Bank, pursuant to 12 U.S.C. §1421, *et seq.*, to its stockholders', Appellants herein, as income under the provisions of the Oklahoma Income Tax Code?

2. Does 31 U.S.C. §§742 and 742a. provide an exemption from state taxation for dividends paid to stockholders from the net earnings of the Federal Home Loan Bank accruing as a result of the Bank's profitable operations?

DESIGNATION OF CORPORATE RELATIONSHIPS

Sooner Federal Savings and Loan Association, Kay County Federal Savings and Loan Association, and First Federal Savings and Loan Association of Lawton, filing this Jurisdictional Statement as Appellants in this proceeding state that:

Kay County Federal Savings and Loan Association, a Charter K (Revised) association, was merged into Sooner Federal Savings and Loan Association, a Charter K (Revised) association, on March 1, 1974. First Federal Savings and Loan Association, a Charter N association, was merged into Sooner Federal Savings and Loan Association on January 1, 1976. This relationship has remained to the present time.

Sooner Federal Savings and Loan Association existed as a Charter K (Revised) association until December 16, 1981. On that date Sooner Federal Savings and Loan Association became a federal Charter S stock association. It has existed in this form to the present date.

TABLE OF CONTENTS

Page

QUESTIONS PRESENTED ..... *i*

DESIGNATION OF CORPORATE RELATIONSHIPS .... *i*

OPINIONS BELOW 1

JURISDICTION 2

STATUTORY PROVISIONS 4

STATEMENT OF THE CASE 5

THE FEDERAL QUESTION IS SUBSTANTIAL 8

State Taxation is Precluded under 12 U.S.C. §1433 8

State Taxation is Precluded under 31 U.S.C. §742 and 742a 11

CONCLUSION 14

APPENDIX A 1-A

APPENDIX B 11-A

APPENDIX C 16-A

APPENDIX D 18-A

APPENDIX E 20-A

APPENDIX F 21-A

APPENDIX G 33-A

APPENDIX H 35-A

APPENDIX I 36-A

APPENDIX J 38-A

APPENDIX K 39-A

TABLE OF AUTHORITIES

CASES *Page*

Austin v. Aldermen of Boston, 74 U.S. 694, 699, 19 L.Ed. 224, 226 (1869), 7 Wall 694 (1869) 13

Dunn v. Board of Tax Appeals, 154 Ohio 42, 93 N.E. 2d 278, 281 (Ohio 1950) 13

Federal Land Bank v. Bismark, 314 U.S. 95, 86 L.Ed. 65 (1941) 9, 10

First Federal Savings and Loan Association of Altadena v. Johnson, State Treasurer, et al., 122 P.2d 84 (Cal. 3rd Dist. Ct. App. 1942) 12

Green Bay & Mississippi Canal Company v. Patten Paper Company, 172 U.S. 58, 43 L.Ed. 364 (1898) 3

Hammond v. Whittredge, 204 U.S. 538, 51 L.Ed. 606 (1907) 3

Laurens Federal Savings and Loan Association v. South Carolina Tax Commission, 365 U.S. 517, 5 L.Ed.2d 749 (1961) 10

Market S.R. Co. v. Railroad Comm. of California, 324 U.S. 548, 89 L.Ed. 1171 *reh. denied*, 324 U.S. 890, 89 L.Ed. 1438 (1945) 3

Mayo v. United States, 319 U.S. 441, 87 L.Ed. 1504 (1943) 13

McCullough v. Maryland, 17 U.S. 316, 4 L.Ed. 579 (1819) 13

Piasa First Federal Savings and Loan Association v. U.S., 441 F.2d 399 (7th Cir. 1971) 12, 13

Pittman v. Home Owners Loan Corporation, 308 U.S. 21, 84 L.Ed. 11 (1939) 10

Page

Sooner Federal Savings and Loan Association, et al., v. Oklahoma Tax Commission and the State of Oklahoma, _____ *P.2d*_____, No. 54, 607 (Okla 1982) 1

STATUTES (UNITED STATES)

Federal Reserve Act §7, 12 U.S.C. §531 9

Federal Farm Loan Act §26, 12 U.S.C. §931; repealed by Act Dec. 10, 1971, P.L. 92-181, Title V, §5.26, 85 Stat. 624; see NOW 12 U.S.C. §2055 .... 9, 10

Federal Home Loan Bank Act of 1932, 47 Stat. 725, 12 U.S.C. §§1421-1449 .....i, 5

Federal Home Loan Bank Act of 1932, §2(4) 6

Federal Home Loan Bank Act of 1932, §6(c) 6

Federal Home Loan Bank Act of 1932, §6(c) (2) (ii) 6

Federal Home Loan Bank Act of 1932, §10(c) 6

Home Owners' Loan Act of 1933, 48 Stat. 128, 12 U.S.C. §§1461-1468..... 5

12 U.S.C. §1433 .....i, 2, 4, 8, 9, 11

12 U.S.C. §1436 .....11, 13

12 U.S.C. §1437(b) 5

12 U.S.C. §1464(h) 5, 8

28 U.S.C. §1257(2) 3

31 U.S.C. §742 .....i, 2, 4, 5, 12, 14

31 U.S.C. §742a .....i, 2, 4, 5, 12, 14

STATUTES (STATE OF OKLAHOMA)

Title 68 O.S.A. (Supp. 1974) §2353, *et seq.* 2

Title 68 O.S.A. (Supp. 1974) §2353.....4

Title 68 O.S.A. (Supp. 1974) §2358 A.2.....2, 5

LEGISLATIVE HISTORY

H.R. Rep. No. 69, 63rd Cong., 1st Sess. P.39..... 9

H.R. Rep. No. 1876, 77th Cong., 2d Session, 3/6/41, P.1 12

No. _____

In the Supreme Court of the United States

OCTOBER TERM, 1982

SOONER FEDERAL SAVINGS AND LOAN ASSOCIATION, KAY COUNTY FEDERAL SAVINGS AND LOAN ASSOCIATION, and FIRST FEDERAL SAVINGS AND LOAN ASSOCIATION OF LAWTON

Appellants

v.

OKLAHOMA TAX COMMISSION, and THE STATE OF OKLAHOMA

Appellees

ON APPEAL FROM THE SUPREME COURT OF THE STATE OF OKLAHOMA

JURISDICTIONAL STATEMENT

OPINIONS BELOW

The opinion of the Oklahoma Supreme Court entered October 5, 1982, and the Order of the Oklahoma Tax Commission, dated December 4, 1979, are set out in Appendix A and B, respectively, hereto. The decision of the Supreme Court of Oklahoma is reported as *Sooner Federal Savings and Loan Association, et al. v. Oklahoma Tax Commission and the State of Oklahoma,* _____P.2d_____, No. 54,607 (Okla. 1982).

JURISDICTION

This action for relief from state taxation draws into question the validity of Title 68 Oklahoma Statutes (Supp. 1974) §2353, *et seq.*, insofar as those sections attempt to tax dividends received by Appellants from the Federal Home Loan Bank. It is Appellants' position that those sections of the Oklahoma statutes which purport to tax such dividends are repugnant to 12 U.S.C. §1433, a duly enacted law of the United States, which specifically exempts "capital," "reserves," "surplus," "advances" and *"income"* of a Federal Home Loan Bank from state taxation. In the alternative, Appellants submit that these same sections of the Oklahoma statutes are repugnant to 31 U.S.C. §742 and 742a., duly enacted laws of the United States, which clearly exempt from all but federal taxation the *"stock"* and *"dividends"* of federal instrumentalities such as the Federal Home Loan Bank.

The federal question relating to 12 U.S.C. §1433 was timely raised by Appellants in their initial claims for refund to the Oklahoma Tax Commission and has been continuously raised on appeal. The federal question relating to 31 U.S.C. §§742 and 742a. was initially raised by Appellee in its Answer Brief filed with the Supreme Court of Oklahoma on August 20, 1980, and has been a part of the record since that time.

On December 4, 1979, the Oklahoma Tax Commission (Order No. 79-12-04-06) held against Appellants ruling that Title 68 Oklahoma Statutes (Supp. 1974) §2358 A.2., was not applicable to the income received by Appellants in this situation. This section generally provides for a deduction from Oklahoma taxable income of any item of income that the State is prohibited from taxing under the federal or state constitutions, or other federal or state laws. On October 5, 1982, the Supreme Court of Oklahoma affirmed; all Justices agreeing that

the Order of the Oklahoma Tax Commission taxing Appellants' dividend income received on the basis of their stock ownership in the Federal Home Loan Bank was authorized and proper in its application.

A Motion to Stay Mandate of the Supreme Court of Oklahoma was filed by Appellants on October 14, 1982. The Motion to Stay Mandate was granted by the Supreme Court of Oklahoma on the 25th day of October, 1982. Both the Motion to Stay Mandate and the Order of the Supreme Court of Oklahoma are set out in Appendix C and D, respectively. Notice of Appeal to this Court was timely filed on October 14, 1982. Said Notice of Appeal is reproduced in full at Appendix E hereto.

The jurisdiction of the United States Supreme Court to review this decision of the Supreme Court of Oklahoma on appeal is conferred by 28 U.S.C. §1257(2). The following decisions sustain the jurisdiction of the Supreme Court to review the judgment on appeal in this case: *Hammond v. Whittredge,* 204 U.S. 538, 51 L.Ed. 606 (1907); *Green Bay & Mississippi Canal Company v. Patten Paper Company,* 172 U.S. 58, 43 L.Ed. 364 (1898).

It should also be noted that a Motion for Rehearing of this matter was not filed by Appellants with the Supreme Court of Oklahoma. Such a request is not necessary to a finding that a decision is final under the provisions of 28 U.S.C. §1257. [See *Southern R. Co. v. Clift,* 260 U.S. 316, 67 L.Ed. 283 (1922); and *Market S.R. Co. v. Railroad Comm. of California,* 324 U.S. 548, 89 L.Ed. 1171 (1945), *reh. denied.* 324 U.S. 890, 89 L.Ed. 1438 (1945)].

STATUTORY PROVISIONS

Title 68 Oklahoma Statutes (Supp. 1974) §2353, 10., 11., 12., 13. is set out in full in Appendix G hereto. In pertinent part, the statute provides:

> " . . . 10. 'Taxable income' with respect to any taxpayer means the 'taxable income' . . . as defined in the Internal Revenue Code as [it] applies to such taxpayer or any income of such taxpayer; . . .
>
> * * *
>
> . . . 12. 'Oklahoma taxable income' means 'taxable income' as reported . . . to the federal government . . .
>
> * * *
>
> . . . 13. 'Oklahoma adjusted gross income' means 'adjusted gross income' as reported to the federal government."

Under Federal law, 12 U.S.C. §1433 specifies in relevant part:

> "Any and all notes, debentures, bonds, and other such obligations issued by any bank, and consolidated Federal Home Loan Bank bonds and debentures, shall be exempt both as to principal and interest from all taxation (except surtaxes, estate, inheritance, and gift taxes) now or hereafter imposed by the United States, by any Territory, dependency, or possession thereof, or by any state, county, municipality, or local taxing authority. The bank,including its franchise, its capital, reserves, and surplus, its advances, and its income, shall be exempt from all taxation now or hereafter imposed by the United States, by any territory, dependency, or possession thereof, or by any state, county, municipality or local taxing authority, . . . "

This statute is more fully set out in Appendix H, hereto.

In addition, 31 U.S.C. §§742 and 742a. provide in pertinent part:

"§742 Exemption from Taxation
All stocks, bonds, treasury notes and other obligations of the United States, shall be exempt from taxation . . . "

* * *

"§742a. Application of Other Law
(a) *Exemption from taxation under Internal Revenue Code; exceptions.*
Interest upon obligations and dividends . . . from shares . . . of stock . . . issued on or after the effective date of the Public Debt Act of 1942 . . . by the United States or any agency or instrumentality thereof shall not have any exemption . . . except as provided under the Internal Revenue Code of 1954. . . . "

These statutory sections are set out in full in Appendix I, hereto.

Title 68 Oklahoma Statutes (Sup. 1974) §2358A.2. and 12 U.S.C. §1464(h) are also set out in full at Appendix J and K, respectively.

STATEMENT OF THE CASE

Appellants are all Federal Savings and Loan Associations organized under the Home Owners' Loan Act of 1933, 48 Stat. 128, 12 U.S.C. §§1461-1468, and all are doing business within the State of Oklahoma under the present corporate name of Sooner Federal Savings and Loan Association. Additionally, Appellants are members of the Federal Home Loan Bank which was established under the authority of the Federal Home Loan Bank Act of 1932, 47 Stat. 725, 12 U.S.C. §§1421-1449.

The Federal Home Loan Bank is subject to regulation and supervision by the Federal Home Loan Bank Board, which is an independent agency within the Executive Branch of the Federal Government [12 U.S.C. §1437(b)].

Congress created Federal Home Loan Banks to furnish reserve banking facilities for savings and loan associations and similar banking institutions which loan mortgage money to home buyers. The Federal Home Loan Bank System, as created, is one element of a tripartite national credit system of federal instrumentalities made up of the Federal Reserve System, the Federal Farm Loan System and the Federal Home Loan Bank System. These systems respectively fulfill the function of supplying credit to the business community, farmers and homeowners throughout the country.

On July 22, 1932, the Federal Home Loan Banks began requiring each member institution to purchase a minimum number of shares of stock in the Bank. This ownership is not voluntary, but rather is a condition of membership in the Federal Home Loan Bank System. Section 2(4) of the Federal Home Loan Bank Act of 1932, *supra,* provides the statutory definition of a Federal Home Loan Bank member as an "institution which has subscribed" for Bank stock.

Section 6(c) of the Federal Home Loan Bank Act of 1932, *supra,* provides a formula for the amount of stock each member must own and maintain as long as it retains membership in the Federal Home Loan Bank. This amount, in turn, is directly related to the members' advances [§6(c)(2)(ii)] and under §10(c) of the Act, each Bank has a statutory lien on the stock issued to borrowing members as security for its advances.

Based on the Appellants' ownership of stock in the Federal Home Loan Bank, they received dividends for the years 1972, 1973 and 1974. After paying their 1972, 1973 and 1974 Oklahoma corporation income tax on the dividends received in the aggregate amount of $13,802.12, Appellants filed claims for refund for like amount on February 3, 1976 with the Income

Tax Division of the Oklahoma Tax Commission.[1] These claims were subsequently denied by the Oklahoma Tax Commission during May, 1976.

Following this action, Appellants protested the denial of their claims for refund to the Oklahoma Tax Commission. The protest was docketed and a hearing on the merits was set for February 23, 1979. The Hearing officer, on October 25, 1979, issued Findings and Recommendations which again denied Appellants' claims for refund.

Pursuant to such Findings and Recommendations, Order No. 79-12-04-06, dated December 4, 1979 was issued by the Oklahoma Tax Commission formally denying Appellants' claims for refund.

Appellants timely filed their Appeal (Petition in Error) with the Supreme Court of Oklahoma to review the Order of the Oklahoma Tax Commission on January 2, 1980. However, the Supreme Court of Oklahoma, on October 5, 1982, affirmed the judgment and Order of the Oklahoma Tax Commission providing for the taxation of dividends received by Appellants from the Federal Home Loan Bank.

In its opinion, the Supreme Court of Oklahoma recognized that 12 U.S.C. §1433 prohibits taxation of income of the Federal Home Loan Bank, but distinguished this case on the

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[1] The claims for refund were submitted in the following manner for each of Appellants:

Sooner Federal Savings & Loan Association		Kay County Federal Savings & Loan Association		First Federal Savings & Loan Association of Lawton	
1972	$2,547.20	1972	$137.89	1972	$ 64.28
1973	4,270.35	1973	96.96	1973	123.75
1974	6,182.19	1973	248.25	1974	319.25
Total	$12,802.74		$483.10		$319.28

basis that the statute does not prohibit taxation of the income of federally chartered savings and loan associations. The Court instead relied on 12 U.S.C. §1464(h) which permits the states to impose a tax upon the income of federally chartered savings and loan associations so long as the taxation does not discriminate against these particular associations. By applying the language of 12 U.S.C. §1464(h) to the Oklahoma income tax statutes, the Court found that the Appellants herein had not complained that either the Oklahoma tax was discriminatory or that their income was not subject to state taxing powers as are other Oklahoma financial institutions. Therefore, the court concluded that Appellants were not a federal instrumentality as described in 12 U.S.C. §1433, and affirmed the judgment of the Oklahoma Tax Commission.

THE FEDERAL QUESTION IS SUBSTANTIAL

State Taxation is Precluded Under 12 U.S.C. §1433.

During the years 1972, 1973 and 1974, Appellants received dividends based upon stock ownership in the Federal Home Loan Bank. Amounts received as dividends were timely reported as income on each of Appellants' 1972, 1973 and 1974 state income tax returns. Timely claims for refund were filed by Appellants with the Oklahoma Tax Commission to obtain refunds of taxes paid that were attributable to these dividends. The Oklahoma Tax Commission, as affirmed by the Supreme Court of Oklahoma, denied these claims for refund on the basis that 12 U.S.C. §1433 is inapplicable in this situation as Appellants are not an exempt "federal instrumentality" as contemplated by the statute. Furthermore, both tribunals concluded that State taxation is permissible in this instance so long as it does not discriminate against Appellants as specified in 12 U.S.C. §1464(h). (See Okla. Sup. Ct. opin. App. pp 7-A–10-A)

The Oklahoma statutes in question recognize that income is to be returned on the basis of taxable income and adjusted gross income as those terms are defined in the Internal Revenue Code. Moreover, the Oklahoma statutes clearly contemplate a deduction for amounts of income the State is prohibited from taxing by virtue of federal law. The federal law involved herein, 12 U.S.C. §1433, specifically provides an exemption from taxation for the Federal Home Loan Bank, including its franchise, capital, reserves, surplus, advances and its *income.* Appellants submit that this exemption is similar to those found in connection with the Federal Reserve Bank (Federal Reserve Act §7, 12 U.S.C. §531) and the Federal Land Bank (Federal Farm Loan Act §26, 12 U.S.C. §931; repealed by Act. Dec. 10, 1971, P.L. 92-181, Title V, §5.26, 85 Stat. 624; See NOW 12 U.S.C. §2055.). While the legislative history of 12 U.S.C. §1433 is not pertinent to this point, the broad scope which Congress intended to give a similar section, 12 U.S.C. §531 (Federal Reserve Bank) is enlightening in ascertaining the legislative impetus behind 12 U.S.C. §1433. The Congressional record reveals in connection with this statute:

> "Attention should also be given to the provision exempting Federal reserve banks and the stock held therein by member banks from *all classes of taxation* save such taxation as may be imposed upon the real estate held by these banks. In view of the increasing burden of taxation and of the Federal income-tax law, which now furnishes an additional draft upon net earnings, this exemption is likely to prove of material importance, since it amounts to an exemption of a corresponding proportion of the funds of member banks from the payment of taxes to which they would otherwise be subjected." (Emphasis Supplied).
> (See H. Rept. No. 69, 63rd Cong. 1st Sess. P.39)

In the same vein, the Federal Farm Loan Act exemption

from taxation [12 U.S.C. §931 (repealed)] has been given a broad scope in its interpretation. In *Federal Land Bank v. Bismark,* 314 U.S. 95, 86 L.Ed. 65 (1941), this Court held that 12 U.S.C. §931 (repealed) was broad enough to invalidate a sales tax imposed on building materials purchased by a Federal Land Bank. In its opinion, this Court determined that the term "including" appearing in the statute does not strictly limit the areas of exemption. Toward this end, this Court stated on page 100:

> " . . . the term 'including' is not one of all embracing definition, but connotes simply an illustrative application of the general principal . . . If the broad exemption accorded to every 'Federal Land Bank' were limited to the specific illustrations mentioned in the participial phrase introduced by 'including,' there would have been no necessity to exempt . . . the real estate held by the land banks."

In addition, an analogous situation to the circumstances presented herein is found in this Court's decision in *Laurens Federal Savings and Loan Association v. South Carolina Tax Commission,* 365 U.S. 517, 5 L.Ed. 2d 749, (1961). In the *Laurens* case, this Court invalidated a documentary stamp tax imposed upon promissory notes executed by a savings and loan association in the State of South Carolina. The opinion concluded that the tax constituted a prohibited tax on Federal Home Loan Bank advances, and, more importantly, it was of "no determining significance" that the association, rather than the lending bank, was responsible for remitting the tax. [See also *Pittman v. Home Owners Loan Corporation,* 308 U.S. 21, 84 L.Ed. 11 (1939).]

The conclusion in the *Laurens* and *Pittman* decisions is even more significant in light of the fact that neither the Oklahoma Tax Commission nor the Supreme Court of Oklahoma discussed or even cited these opinions, which had

been argued and cited in Appellant's briefs, in connection with arriving at their respective decisions. Furthermore, both decisions avoided any reference to an opinion, contained in the record, of the General Counsel of the Federal Home Loan Bank Board originally forwarded to Mr. Harry C. Erwin, CPA, concerning the American Savings and Loan Association which concluded that state taxation of dividends received from the Bank by a stockholder association is prescribed under 12 U.S.C. §1433. A copy of this opinion is set out in full at Appendix F.

In view of the legislative history and cases cited above, Appellants would argue that the dividends, which by statute (12 U.S.C. §1436) must be derived from the net income of the Bank, are not subject to taxation under the mandate of the Oklahoma income tax statutes. This conclusion is inescapable, regardless of the fact that the dividends are received by federally chartered savings and loan associations. The tax, in this instance, is being imposed on the net income of the Federal Home Loan Bank, which has merely been distributed to its stockholders.

In summary, the opinion of the Supreme Court of Oklahoma cannot be squared with the mandate of federal law and the earlier decisions of this Court. As a result, the opinion warrants a swift, summary reversal by this Court.

State Taxation Is Precluded Under 31 U.S.C. §§742 and 742a.

The opinion of the Supreme Court of Oklahoma purportedly attempts to distinguish between the Federal Home Loan Bank and a federally chartered savings and loan association on the basis that the Bank, unlike a federally chartered savings and loan association, is the only "federal instrumentality" exempt from state taxation under the federal statute. Furthermore, the Court concluded that a federally chartered savings

and loan association may not be classified as a federal instrumentality as that term is contemplated within the statute by either direct reference or by implication. Consequently, the Court found that the tax was not being imposed on the income of an exempt entity, but, rather, on the income of non-exempt savings and loan associations. (See Okla. Sup. Ct. opin. App. A, pp. 6-A-10-A.)

Appellants believe that the opinion of the Supreme Court of Oklahoma, summarized above, ignores the clear language of 31 U.S.C. §§742 and 742a. in favor of an opinion of the California Court of Appeals. (See Okla. Sup. Ct. opin. App. P. 7-A, citing to *First Federal Savings and Loan Association of Altadena v. Johnson, State Treasurer, et al,* 122 P.2d 84 (Cal. 3rd Dist. Ct. App. 1942).

Initially, Section 742, as amended by 742a., specifically exempts, *inter alia,* from all but federal taxation dividends from stock issued by the United States, or an instrumentality of the United States. In view of the citations outlined above, Appellants believe it is well established that the Federal Home Loan Bank would qualify as an instrumentality of the United States. Consequently, it logically follows that dividends paid to stockholders of the Federal Home Loan Bank would be exempt from all but federal taxation.

The fact that shares and other instruments of ownership are exempt from all but federal taxation taxation is most clearly illustrated by the legislative history of Section 742a. as contained in House Report, No. 1876, 77th Cong., 2d Session, 3/6/41, P. 1. In this passage, the committee states:

> 'The bill is designed . . . to subject all shares and other evidences of ownership issued in the future by any agency or instrumentality of the United States to *federal taxation* by removing all privileges of exemptions *from such taxation* which they now enjoy." (Emphasis supplied)

Consequently, the legislation was clearly federal in nature, and should not be interpreted to permit state or local taxation. [See *Piasa First Federal Savings and Loan Association v. U.S.*, 441 F.2d 399 (7th Cir. 1971).]

The failure by Congress to expressly end the exemption from state and local taxation mandates the retention of the exemption. [See *McCullough v. Maryland*, 17 U.S. 316, 4 L.Ed. 579 (1819).] In *Mayo v. United States*, 319 U.S. 441, 87 L.Ed. 1504 (1943), this Court held that where the governmental action is carried on by the United States itself, and Congress does not affirmatively declare its instrumentalities or property subject to regulation or taxation, the inherent freedom from taxation continues. Similarly, this Court earlier observed that Congress could waive a federal instrumentality's exemption from state taxation, "but the waiver must be clear, and every well-grounded doubt on the subject should be resolved in favor of the exemption." [See *Austin v. Aldermen of Boston*, 74 U.S. 694, 699, 19 L.Ed. 224, 226 (1869).] Indeed, the Supreme Court of Ohio, in *Dunn v. Board of Tax Appeals*, 154 Ohio 42, 93 N.E. 2d 278, 281 (Ohio 1950), recognized that although a state may tax instrumentalities of a national government if the latter consents thereto, such waiver or consent must be duly authorized and clearly given.

Finally, the holding of the Supreme Court of Oklahoma, characterizing the dividends received by Appellants as income to other than an exempt federal instrumentality, ignores the obvious fact that the dividends are derived directly from the net earnings of the Federal Home Loan Bank. (See 12 U.S.C. §1436) If the Bank had not realized net earnings, the dividends could not, by statute, have been paid to Appellants. Moreover, if this tax is permitted to be imposed, the cost of operating federally chartered savings and loan associations, such as Ap-

pellants, will undoubtedly increase; thereby raising the specter of increased borrowing costs to those seeking mortgage money in an already inflation ravaged market.

In conclusion, the decision of the Supreme Court of Oklahoma has not carefully considered the inherent limitations of 31 U.S.C. §§742 and 742a., and, therefore, the opinion requires reversal by this Court to prevent an abuse of federal law.

CONCLUSION

The decision of the Supreme Court of Oklahoma imposing a tax on the dividends received by Appellants from the Federal Home Loan Bank should be accorded plenary review by this Court. In addition, this Honorable Court should allow the parties to provide briefs on the merits and to present oral arguments to assist in the resolution of this matter.

Respectfully submitted,

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Attorneys for Appellants, Sooner Federal Savings and Loan Association, et al.

APPENDIX A

No. 54,607

IN THE SUPREME COURT OF THE STATE OF OKLAHOMA

SOONER FEDERAL SAVINGS & LOAN ASSOCIATION, KAY COUNTY FEDERAL SAVINGS & LOAN ASSOCIATION, and FIRST FEDERAL SAVINGS & LOAN ASSOCIATION OF LAWTON
Appellants

v.

OKLAHOMA TAX COMMISSION, and THE STATE OF OKLAHOMA
Appellee

APPEAL FROM THE OKLAHOMA TAX COMMISSION
ORDER NO. 79-12-04-06

SOONER FEDERAL SAVINGS & LOAN ASSOCIATION, KAY COUNTY FEDERAL SAVINGS & LOAN ASSOCIATION, AND FIRST FEDERAL SAVINGS & LOAN ASSOCIATION OF LAWTON, APPEAL FROM AN ORDER OF THE OKLAHOMA TAX COMMISSION DENYING THEIR CLAIMS FOR REFUNDS OF STATE INCOME TAXES PAID.

AFFIRMED

E. John Eagleton,
James A. Hogue, Sr.
Houston and Klein, Inc.
Tulsa, Oklahoma, *For Appellants,*

Donna E. Cox,
Oklahoma City, Oklahoma, *For Appellee.*

BARNES, V.C.J.:

This case is before the Court on appeal by Sooner Federal Savings & Loan Association, Kay County Savings & Loan Association and First Federal Savings & Loan Association of Lawton, from Order No. 79-12-04-06, issued December 4, 1979 by the Oklahoma Tax Commission, denying claims for refund of state income tax paid for taxable years 1972, 1973 and 1974. In their claims before the Commission, appellants sought refunds of state corporate income tax liabiliity calculated, reported and paid on dividends distributed to appellants on stock issued by a Federal Home Loan Bank.

All the facts were presented to the Commission upon stipulation and are as follows:

1. Appellants are federally charted savings and loan associations.

2. Appellants are required to own stock in Federal Home Loan Bank as a condition of membership in the federal home loan bank system.

3. Appellants received dividends on Federal Home Loan Bank stock owned by them in the years 1972, 1973 and 1974 and subsequent income tax years.

4. Appellants voluntarily reported and paid Oklahoma corporation income taxes on said dividends under Oklahoma Income Tax Code, Title 68 O.S. 1981 §2351 et seq., in the total amount of $13,802.12 for the years 1972, 1973, and 1974, which taxes are claimed by the state solely by virtue of the dividends received by appellants on Federal Home Loan Bank stocks owned by them.

5. Federal Home Loan Bank was organized and exists by virtue of the Federal Home Loan Bank Act, 12 U.S.C. §1421 et seq.

6. Congressional history of 12 U.S.C. §1433 reveals said section was enacted to provide funds more cheaply to home buyers.

7. Section 6(c) of the Federal Home Loan Bank Act provides a formula for the amount of stock each member association must own and maintain as long as it retains Bank membership, which amount is directly related to the member's advances, i.e., as the amount of stock paid in by a member association increases, its maximum amount of aggregate outstanding stock increases.

The issue before the Court is whether dividends disbursed by Federal Home Loan Bank, pursuant to 12 U.S.C. §1421 et seq., to its stockholders, appellants, are subject to taxation under the Oklahoma Income Tax Code as income of said appellants.

Order No. 79-12-04-06, issued by the Commission after full hearing, included findings that the dividends claimed to be exempt from state tax is income to appellants and subject to nondiscriminatory state income tax as authorized by 12 U.S.C. §1464.

Appellants advance two main contentions. The first is that §1433 of 12 U.S.C. exempts from state taxation dividends on stock issued by Federal Home Loan Banks to its members. The pertinent part of said section is as follows:

> "Any and all notes, debentures, bonds and other such obligations issued by any bank, and consolidated Federal Home Loan Bank bonds and debentures, shall be exempt both as to principal and interest from all taxation (except surtaxes, estate, inheritance, and gift taxes) now or hereafter imposed by the United States, by any territory, dependency, or possession thereof, or by any state, county, municipality, or local taxing authority. The bank, including its franchise, its capital, reserve,

and surpluses, its advances, and its income, shall be exempt from all taxation now or hereafter imposed by the United States, by any territory, dependency, or possession thereof, or by any state, county, municipality, or local taxing authority; . . . "

Appellants further urge that "exemption" clauses "similar" to §1433, *supra,* are found in the Federal Reserve Act, Federal Farm Loan Act, and Federal Home Loan Bank Act, pertaining to Federal Reserve Banks, Federal Land Banks and Federal Home Loan Banks, respectively. Appellants also cite a portion of 12 U.S.C. §531 as showing intent of Congress in §1433, *supra,* to exempt their stock from state taxation, and underline that part relied on as follows:

"Attention should also be given to the provisions exempting Federal Reserve Banks, *and the stock held therein by member banks from all classes of taxation.*"

Appellants state therefore since they are members of the Federal Home Loan Bank, and hold stock therein, dividends paid on that stock is tax exempt.

Appellant's second contention is that Congress has not expressly or impliedly declared that its instrumentalities (Federal Home Loan Banks) are subject to state taxation as pertaining to the specifically mentioned items in §1433, *supra.*

Appellee, Oklahoma Tax Commission, counters that 12 U.S.C. §1464(h) controls in this case and not §1433, *supra.*

12 U.S.C. §1464 created federally charted savings and loan associations and mandated automatic membership of the associations in a Federal Home Loan Bank.

12 U.S.C. §1464(h) is as follows:

"No state, county, municipal, or local taxing authority shall impose any tax on such associations or their franchise,

capital, reserves, loans, or income greater than that imposed by such authority on other similar local mutual or cooperative thrift and home financing institutions."

Appellee also cites 12 U.S.C. §1464(k):

"All stock of any federal home loan bank shall share in dividend distributions without preference."

And, 12 U.S.C. §1436:

" . . . No dividends shall be paid except out of net earnings remaining after all reserves and charge-offs required under this chapter have been provided for . . . "

In referring to 12 U.S.C. §1464(h), §1426(k) and §1436, *supra,* appellee contends these enactments show Congressional intent that federally chartered savings and loan associations should enjoy dividend income from their Federal Home Loan Bank stock, paid without preference out of the net earnings of the Federal Home Loan Bank, and that the savings and loan associations should pay a state tax imposed in a nondiscriminatory manner on their respective incomes; that Congress did not declare federally chartered savings and loan associations to be federal instrumentalities, nor grant them an exemption on their dividend income from state taxation; that Congress, by enacting §1433, *supra,* expressly protects its purely governmental entities from state taxation and specifically sets forth Federal Home Loan Banks as one such entity, that in enacting §1433, *supra,* Congress could have just as expressly included the income of federally chartered savings and loan associations in the tax exemption but it did not.

We agree with appellee that its order of December 4, 1979 taxing appellants' dividend income from their stock in Federal Home Loan Bank is authorized by §1464(h), *supra,* and is proper in its application.

Appellants do not complain that the Oklahoma tax imposed is discriminatory or that their income, other than their dividends from Federal Home Loan Bank stock, is not subject to state taxing powers as are other similar financial institutions in Oklahoma, but only that this particular income is exempt under §1433, *supra.*

However, §1433, *supra,* as heretofore stated, does not set forth, or even imply, that federally chartered savings and loan associations were to be included in the exemption granted to Federal Home Loan Banks, but does specifically name, along with *"any bank,"* Federal Home Loan Banks. The section also states, the *bank,* (referring to Federal Home Loan Bank), including *its* franchise, *its* capital, reserves and surpluses, *its* advances, and *its* income, shall be exempt . . . " (emphasis added)

Thus §1433, *supra,* by its very language, intends that the Federal Home Loan Bank be exempt from state taxation and in no way refers to federal savings and loan associations.

Appellants second contention is that the tax imposed by appellee on their dividend income is a tax on a federal instrumentality and is therefore contrary to constitutional and statutory provisions.

The general rule is that the states are without power to tax a federal instrumentality without consent of Congress. *McCullough v. Maryland,* 17 U.S. 316 (Md. 1918); *Colorado National Bank v. Belford,* 310 U.S. 1 (Colo. 1940); *Federal Land Bank v. Bismark,* 314 U.S. 995 (1941); *Federal Land Bank v. Board of County Commissioners,* 368 U.S. 146 (1961).

However, federally chartered savings and loan associations are not federal instrumentalities within the meaning of the statutory provisions. They are not national banks, federal reserve banks, federal land banks, or federal home loan banks,

to which immunity from state taxation is made clear and we find no authority to support appellants' contention that the tax immunity granted to these federal instrumentalities should extend to the dividend income of appellants from their stock in Federal Home Loan Bank.

A review of case law involving §1464(h) supports nondiscriminatory state taxation of *all* the income of federal savings and loan associations. (emphasis added).

In *First Federal Savings and Loan Association of Altadena v. Johnson, State Treasurer, et al,* 122 P.2d 84 (Cal. 1942), First Federal Savings sought a refund of franchise taxes paid on that portion of its net income derived from funds invested by the federal government. First Federal Savings, just as appellants here, contended the tax was illegally levied because its income was exempt from all state taxes since it was an agency of the United States, and Congress had not affirmatively authorized such income to be taxed because it was income derived from the investment of funds furnished by the government.

As to congressional intent subjecting the income of federal savings and loan associations to state taxes, the California court stated at p. 86 of its opinion:

> "It is acknowledged that Congress may lawfully authorize the states to levy and collect taxes on certain property and assets or income derived from governmental agencies doing business in such states by appropriate legislation therefor. From time to time, ever since 1864, Congress has specifically authorized the states to levy and collect taxes on specified classes of property and income of particular governmental agencies."

In referring to §1464, *supra,* amended by Congress in 1934, authorizing the creation of federal savings and loan associations, the California court continued at p. 86:

"It is not stated that such associations shall become instrumentalities of the United States, . . . Nor is it stated in §1464, *supra*, . . . that the corporations property and assets are exempt from taxation. On the contrary, it is clearly inferred by the provisions of subdivision (h) of §1464, that states are authorized to tax the income derived from such associations."

Continuing at p. 86 the California court said:

"Although the language of subdivision (h) of §1464 with respect to state taxation of federal agencies is negative in form, its meaning is clear and unambiguous."

The California court concluded at p. 88, in referring to the taxability of such income:

"No such limitation is placed upon the taxing power of the states by the provisions of subdivision (h) of §1464. It authorizes the state to tax all incomes of such associations. That provision contemplates the taxing of all such associations of their franchises, capital, reserves, surplus, loans or income to an extent not 'greater than that imposed by such authority on other similar local mutual or cooperative thrift and home financing institutions.' This absence of a limitation leaves the clear inference that the entire income is taxable and that the portion which is derived from loans of funds invested by the federal government is not exempt. If Congress had intended to exempt the income derived from that source it would have so stated."

We find the language in First Federal, supra, very persuasive in its construction of §1464(h), *supra*, in that dividends from Federal Home Loan Bank stock received by member federal savings and loan associations is income subject to state taxation. See also *United States v. New Mexico*, March 24, 1982, 50 LW 4329 (1982).

In *First Federal Savings and Loan Association of Boston*,

et al v. State Tax Commission, et al, 98 S.C. 2333 (Mass. 1978 437 U.S. 255, the United States Supreme Court went directly to the issue of the non-discriminatory taxation aspect of §1464(h), *supra.* First Federal Savings sought a declaratory judgment concerning the power of the State of Massachusetts to impose a tax on federal savings and loan associations. The *Supreme Judicial Court of Massachusetts,* 372 Mass. 478, 363 N.E. 2d 474, upheld the challenged portion of the tax and the savings and loan association appealed. The U.S. Supreme Court treated said section as congressional consent to state taxation of the income of federal savings and loan associations. The Court stated, "It (Section 1464(h)) is one of several laws passed by Congress to protect federally chartered financial institutions from unequal and unfriendly competition caused by state laws favoring state chartered institutions. On its face, however, the Massachusetts tax scheme is not unfriendly or discriminatory."

In *First Federal Savings and Loan Association v. Loomus,* 97 F.2d 831 (Wis. 1938), the 7th Circuit Court of Appeals stated, "12 U.S.C.A. §1464(h) . . . permits state taxation only to the extent that similar state institutions are taxed."

In *Winchester, et al v. Porterfield, Tax Commissioner,* 271 N.E.2d 786 (Ohio 1971), the Ohio court interpreted §1464(h) " . . . which prohibits any state tax which discriminates against a federal association, thus impliedly granting the state power to tax upon the basis of similar treatment of similar local or state institutions."

In reaching our conclusion, we further hold that when a Federal Home Loan Bank distributes dividends to its member federal savings and loan associations, these dividends become income to said members, the disposition of which the Federal Home Loan Bank has no further control. Such becomes in-

come, just as interest on savings and loan association loans to the public, becomes income. The ownership of that income (dividends) has shifted to federal home loan associations, appellants, and these dividends supply income and are a part of the profits of the federal savings and loan associations, and are subject to state taxation under §1464(h), *supra.*

We therefore affirm Order No. 79-12-04-06 of the Oklahoma Tax Commission.

ALL JUSTICES CONCUR.

APPENDIX B

No. P-79-014

BEFORE THE OKLAHOMA TAX COMMISSION THE STATE OF OKLAHOMA

IN THE MATTER OF THE PROTEST OF SOONER FEDERAL SAVINGS & LOAN ASSOCIATION, KAY COUNTY FEDERAL SAVINGS & LOAN ASSOCIATION AND FIRST FEDERAL SAVINGS & LOAN ASSOCIATION OF LAWTON TO THE DENIAL OF CLAIMS FOR REFUNDS OF INCOME TAXES

ORDER NO. 79-12-04-06

This matter came on before the Oklahoma Tax Commission on the 8th day of November, 1979, upon the protest of Sooner Federal Savings & Loan Association, Kay County Federal Savings & Loan Association and First Federal Savings & Loan Assocation of Lawton to the denials of claims for refund of income taxes issued on May 25, 1976, May 21, 1976, and May 26, 1976, respectively, by the Income Tax Division of the Oklahoma Tax Commission and upon the Findings and Recommendations of the hearing officer of the Oklahoma Tax Commission issued on October 25, 1979.

The Commission proceeded to examine the files and records in this matter, and being fully advised in the premises, finds:

1. This matter came on for hearing before the duly appointed hearing officer of the Oklahoma Tax Commission pursuant to §228 of Title 68 of the Oklahoma Statutes.

2. On October 25, 1979, said hearing officer issued Findings and Recommendations in this matter upon consideration of the evidence, oral argument of counselors and hearing briefs presented herein.

3. Said Findings and Recommendations were mailed to counselors for protestants on October 26, 1979.

4. Said findings and recommendations should be adopted and upheld by the Commission as set out hereinafter.

5. Sooner Federal Savings and Loan Association, Kay County Federal Savings and Loan Association and First Federal Savings and Loan Association of Lawton, taxpayers and protestants herein, each voluntarily reported and paid for the 1972, 1973 and 1974 tax years, Oklahoma income taxes on dividends distributed to protestants on stock issued by a Federal Home Loan Bank. And, subsequent thereto, each protestant timely filed claims for refunds for income tax years 1972, 1973 and 1974 for taxes paid on said dividends distributed to said protestants by the Federal Home Loan Bank. And, said claims for refunds were as follows: Sooner Federal Savings and Loan Association submitted claims for refund in the total amount of $12,999.74; Kay County Federal Savings and Loan Association submitted claims for refund in the total amount of $483.10; and, First Federal Savings and Loan Association of Lawton submitted claims for refund in the total amount of $319.28, as set out in protestants' tax returns, Exhibit 1 through 8, both inclusive, admitted at the hearing of this matter, plus statutory interest accumulating.

6. Each of said claims of protestants for refund of income taxes paid was denied by the Director of the Income Tax Division of the Oklahoma Tax Commission as set out in Exhibits 9, 10, and 11, admitted at the hearing of this matter.

7. Each of said denials of said claims for refund of income taxes paid were timely protested in accordance with §2373 and §228 of Title 68 of the Oklahoma Statutes as set out in Exhibit 12, admitted at the hearing in this matter.

8. Protestants are federally chartered savings and loan associations.

9. Protestants are required to hold stock in the Federal Home Loan Bank system.

10. Protestants received dividends on the Federal Home Loan Bank's Stock held by them in the years 1972, 1973, and 1974, and subsequent tax years.

11. The Federal Home Loan Bank in which claimants hold stock is organized and exists by virtue of an act of Congress, the Federal Home Loan Bank Act, 12 U.S.C., Section 1420 et seq.

12. The Congressional history of 12 U.S.C. §§1433 reveals that that section was enacted to provide funds more cheaply to home buyers.

13. Section 6(c) of the Federal Home Loan Bank provides a formula for the amount of stock each member association must hold and maintain as long as it retains bank membership, which amount is directly related to the members' advances, i.e. as the amount of stock paid in by member associations increases, its maximum amount of aggregate outstanding stock increases.

14. Pursuant to the language of 12 U.S.C. Sections 1426(k) and 1436, the distributions received by protestants, by virtue of stock issued by Federal Home Loan Bank to the respective protestants, which protestants contend are exempt from state income taxation and claim refunds for Oklahoma income tax paid thereon, are dividends paid from the net earnings of the issuing Federal Home Loan Bank.

15. Dividends distributed by a Federal Home Loan Bank to its stock holding members, protestants herein, constitute income to the member banks.

16. 12 U.S.C. §1433 prohibits taxation of income of Federal Home Loan Banks and does not prohibit taxation of income of federally chartered savings and loan associations.

17. 12 U.S.C. Section 1464(h) permits states to impose state taxation upon the income of federally chartered savings and loan associations which is not greater than the same state taxation imposed by such authority on other similar local mutual or cooperative thrift and home financing institutions.

18. Protestants have not contended or offered any evidence that the Oklahoma income tax paid by them and sought to be refunded herein is in any manner a discriminatory tax.

19. Section 2358 A.2. of Title 68 of the Oklahoma Statutes, providing a deduction from Oklahoma taxable income or adjusted gross income of any income that the state is prohibited from taxing under the Federal or State constitutions or other Federal or state laws, is not applicable to the income involved herein as same is subjected to state taxation by 12 U.S.C. 1464(h). And,

20. The recommendation of the hearing officer that the claims for refund of protestants should be denied as the dividends distributed upon stock issued by Federal Home Loan Banks to protestants are subject to Oklahoma income tax should be upheld.

THEREFORE, IT IS HEREBY ORDERED by the Oklahoma Tax Commission that the claims for refunds of Sooner Federal Savings and Loan Association, Kay County Federal Savings and Loan Association and First Federal Savings and Loan Association of Lawton for income taxes paid for tax years

1972, 1973, and 1974, on dividends distributed on stock issued by Federal Home Loan Banks, shall be, and the same are hereby, denied.

ATTEST

MARY JANE SINCLAIR
Assistant Secretary

APPROVED:

DENNIS G. BALCH
Director
Income Tax Division

APPROVED AS TO FORM:

MARJORIE PATMAN
General Counsel

DONNA E. COX
Attorney

OKLAHOMA TAX COMMISSION

JAMES E. WALKER
Chairman

JOHN L. GARRETT,
Vice Chairman

J. L. MERRILL,
Secretary-Member

APPENDIX C

No. 54,607

IN THE SUPREME COURT OF THE STATE OF OKLAHOMA

SOONER FEDERAL SAVINGS & LOAN ASSOCIATION, KAY COUNTY FEDERAL SAVINGS & LOAN ASSOCIATION, and FIRST FEDERAL SAVINGS & LOAN ASSOCIATION OF LAWTON
Appellants

vs.

OKLAHOMA TAX COMMISSION, and THE STATE OF OKLAHOMA
Appellees

NOTICE OF APPEAL TO THE
SUPREME COURT OF THE UNITED STATES

Notice is hereby given that Sooner Federal Savings and Loan Association, Kay County Federal Savings and Loan Association, and First Federal Savings and Loan Association of Lawton, the Appellants above-named, hereby appeal to the Supreme Court of the United States from the final judgment of the Supreme Court of the State of Oklahoma affirming Order No. 79-12-04-06 of the Oklahoma Tax Commission, entered herein on October 5, 1982.

This appeal is taken pursuant to 28 U.S.C. §1257(2).

Respectfully submitted,
HOUSTON AND KLEIN, INC.

BY: E. JOHN EAGLETON
THOMAS G. POTTS
JAMES A. HOGUE, SR.
Attorneys for Appellants
3200 University Tower
1722 South Carson
P.O. Box 2967
Tulsa, Oklahoma 74101
(918) 583-2131

CERTIFICATE OF MAILING

I, Thomas G. Potts, do hereby certify that a true and correct copy of the above and foregoing Notice of Appeal was forwarded by certified mail this 13th day of October, 1982, with sufficient postage fully prepaid to:

Ms. Donna E. Cox
Oklahoma Tax Commission
2502 Lincoln Blvd.
Oklahoma City, Oklahoma 73204

THOMAS G. POTTS

APPENDIX D

No. 54,607

IN THE SUPREME COURT OF THE STATE OF OKLAHOMA

SOONER FEDERAL SAVINGS & LOAN ASSOCIATION, KAY COUNTY FEDERAL SAVINGS & LOAN ASSOCIATION, and FIRST FEDERAL SAVINGS & LOAN ASSOCIATION OF LAWTON
Appellants

vs.

OKLAHOMA TAX COMMISSION, and THE STATE OF OKLAHOMA
Appellees

MOTION TO STAY MANDATE

COMES NOW, the Appellants, Sooner Federal Savings and Loan Association, Kay County Federal Savings and Loan Association and First Federal Savings and Loan Association of Lawton, and move this Court to stay the mandate of judgment in this matter pending Appellants' appeal to the United States Supreme Court.

Respectfully submitted,
HOUSTON AND KLEIN, INC.

BY: E. JOHN EAGLETON
THOMAS G. POTTS
JAMES A. HOGUE, SR.
3200 University Tower
1722 South Carson
P.O. Box 2967
Tulsa, Oklahoma 74101
(918) 583-2131
Attorneys for Appellants

CERTIFICATE OF MAILING

I, Thomas G. Potts, do hereby certify that a true and correct copy of the above and foregoing Motion to Stay Mandate was forwarded by certified mail this 13th day of October 1982, with sufficient postage fully prepaid to:

Ms. Donna E. Cox
Oklahoma Tax Commission
2502 Lincoln Blvd.
Oklahoma City, Oklahoma 73204

THOMAS G. POTTS

APPENDIX E

No. 54,607

IN THE SUPREME COURT OF THE STATE OF OKLAHOMA

SOONER FEDERAL SAVINGS & LOAN ASSOCIATION, KAY COUNTY FEDERAL SAVINGS & LOAN ASSOCIATION, and FIRST FEDERAL SAVINGS & LOAN ASSOCIATION OF LAWTON
Appellants

vs.

OKLAHOMA TAX COMMISSION, and THE STATE OF OKLAHOMA
Appellees

ORDER

The Court notes appellants' notice of appeal to the Supreme Court of the United States, filed October 14, 1982. The appellants' motion to stay mandate is therefore granted, and issuance of mandate from this Court is stayed until December 6, 1982. If appellants have perfected an appeal to the Supreme Court of the United States on or before such date, then issuance of mandate shall be further stayed until final disposition of the appeal by that Court, or until further order of this Court.

DONE BY ORDER OF THE SUPREME COURT IN CONFERENCE THIS 25th DAY OF OCTOBER, 1982.

Chief Justice

APPENDIX F

Federal Home Loan Bank Board
October 29, 1975

Mr. Harry C. Erwin, CPA
Managing Partner
Russell Brown & Company
900 Boyle Building
Little Rock, Arkansas 72201

FEB. 12, 1979
Legal Opinion

Re: American S&LA
Springdale, Arkansas
FHLBB No. 6416

Dear Mr. Erwin:

Mr. W. O. Churchill, Jr., Office of the Supervisory Agent, Federal Home Loan Bank Board, Little Rock, Arkansas, has advised us of your request for an opinion as to whether the State of Arkansas may include in the taxable income of the American Savings and Loan Association, Springdale, Arkansas, dividends received on the capital stock it holds in the Federal Home Loan Bank of Little Rock.

For the reasons set forth below, it is our opinion that §13 of the Federal Home Loan Bank Act (12 U.S.C. 1433, hereinafter "§13")[1] and that such taxation constitutes a prohibited taxation of a federal instrumentality without the consent of Congress.

---

[1] Section 13 provides in part as follows:

> Any and all notes, debentures, bonds, and other such obligations issued by any bank, and consolidated Federal Home Loan Bank bonds and debentures, shall be exempt both as to principal and interest from all taxation (except surtaxes, estate, inheritance, and gift taxes) now or hereafter imposed by the United States, by any Territory, dependency, or possession thereof, or by any State, county, municipality, or local taxing authority. *The bank, including its franchise, its capital, reserves, and surplus, its advances, and its income shall be exempt from all taxation now or hereafter imposed by the*

The Legal Division, Arkansas Department of Finance and Administration, apparently has concluded that such dividends are not exempt from State taxation since §13 does not specifically refer to dividends on Bank stock and such stock is not an "obligation of the United States" as that term is used in the exemption provisions of 31 U.S.C. 742.[2] Although we agree of course, with the latter contention, we do not agree that dividends on Bank stock are taxable by the State of Arkansas.

A Federal Home Loan Bank, such as the Federal Home Loan Bank of Little Rock, is organized and exists under an Act of Congress, the Federal Home Loan Bank Act (12 U.S.C. 1421 *et seq.*), and is clearly a federal instrumentality. Each such Bank is subject to regulation and supervision by the Federal Home Loan Bank Board, which is an independent agency in the executive branch of the Federal Government (12 U.S.C. 1437(b)). Congress created Federal Home Loan Banks to furnish reserve banking facilities for savings and loan associations and similar banking institutions which loan mortgage money to home buyers. The Federal Home Loan Bank System, so created, is one element of a tripartite national credit system of federal instrumentalities made up of the Federal Reserve System, the Federal Farm Loan System, and the Federal Home Loan Bank

---

Footnote 1 continued:

United States, by any Territory, dependency, or possession thereof, *or by any State, county, municipality, or local taxing authority;* except that in any real property of the bank shall be subject to State, Territorial, county, municipal, or local taxation to the same extent according to its value as other real property is taxed. [Emphasis added.]

[2] 31 U.S.C. 742, as amended, provides in relevant part that:

Except as otherwise provided by law, all stocks, bonds, Treasury notes, and other obligations of the United States, shall be exempt from taxation by or under State or municipal or local authority. . . . "

System, which respectively fulfill the function of supplying credit to the business community, farmers, and homeowners.

In the only case to date to consider the status of a Federal Home Loan Bank, the United States Court of Appeals for the Ninth Circuit determined that such a Bank is a "federal instrumentality organized to carry out public policy and its functions are wholly governmental". *Fahey v. O'Melveny & Myers,* 200 F.2d 420, 446-447 (1952), *cert. denied,* 345 U.S. 952. The *O'Melveny* court also observed that cases dealing with Federal Reserve Banks and Federal Land Banks are pertinent to inquiries concerning Federal Home Loan Banks because of the similarity in their plans and purpose 200 F.2d at 445.

The Supreme Court repeatedly has held that States may not tax federal instrumentalities without the specific consent of Congress. *E.g., McCulloch v. Maryland* 17 U.S. (4 Wheat) 316 (1819); *Colorado National Bank v. Bedford,* 310 U.S. 41 (1940); *Federal Land Bank v. Bismarck,* 314 U.S. 95 (1941); *Federal Land Bank v. Board of County Commissioners,* 368 U.S. 146, 149 (1961). With particular relevance to this case, a long line of decisions by the United States Supreme Court has "firmly established the proposition that the States are without power, unless authorized by Congress, to tax federally created, or, as they are presently called, national, banks". First Agricultural National Bank of Berkshire County v. State Tax Commission, 392 U.S. 339, 340-341 (1968). While the applicability of the foregoing doctrine to national banks at the level of the First National Bank of Little Rock (or any similar commercial national bank) may be subject to question, it is settled law with respect to national banks such as Federal Reserve Banks, Federal Land Banks, and Federal Home Loan Banks (*id.* at 362), even though the obligations of such banks may not be, in a strict legal sense, obligations of the United States. Thus, the Supreme Court, in

the application of this doctrine to Federal Land Banks, stated in *Federal Land Bank v. Bismarck, supra,* 314 U.S. at 102-103:

> The argument that the lending functions of the federal land banks are proprietary rather than governmental misconceives the nature of the federal government with respect to every function which it performs. The federal government is one of delegated powers, and from that it necessarily follows that any constitutional exercise of its delegated powers is governmental. It also follows that, when Congress constitutionally creates a corporation through which the federal government lawfully acts, the activities of such corporation are governmental.
>
> The federal land banks are constitutionally created, and respondents do not urge otherwise. Through the land banks the federal government makes possible the extension of credit on liberal terms to farm borrowers. As part of their general lending functions, the land banks are authorized to foreclose their mortgages and to purchase the real estate at the resulting sale. They are instrumentalities of the federal government, engaged in the performance of an important governmental function. The national farm loan associations, the local co-operative organizations of borrowers through which the land banks make loans to individuals, are also federal instrumentalities.
>
> Congress has the power to protect the instrumentalities which it has constitutionally created. This conclusion follows naturally from the express grant of power to Congress 'to make all laws which shall be necessary and proper for carrying into execution all powers vested by the Constitution in the Government of the United States.' We have held on three occasions that Congress has authority to prescribe tax immunity for activities connected with, or in furtherance of, the lending functions of federal credit agencies [citations and footnotes omitted].
>
> It is significant that Congress has not only failed to

authorize State taxation of the income of the three elements of the national credit system (the Federal Reserve Banks, the Federal Land Banks, and the Federal Home Loan Banks), but has statutorily exempted such income from all forms of State taxation. Federal Reserve Act §7, 12 U.S.C. 531 (hereinafter "§13"); Federal Farm Loan Act §26, 12 U.S.C. 931 (hereinafter "§26"); Federal Home Loan Bank ACt §13, 12 U.S.C. 1433. Each of the three exemptions contains substantially the same language.

Section 7 provides as follows:

> "Federal reserve banks, including the capital stock and surplus therein and the income derived therefrom, shall be exempt from Federal, State and local taxation, except taxes upon real estate". Section 7 was the first "standard exemption" provision (*Federal Land Bank v Bismarck, supra,* 314 U.S. at 101, ftn. 7), and apparently served as a prototype for §§13 and 26. The broad scope that Congress intended to be given to this exemption may be discerned from the following extract from its legislative history:
>
> *Attention should also be given to the provisions exempting Federal reserve banks and the stock held therein by member banks from all classes of taxation,* save such taxation as may be imposed upon the real estate held by these banks. In view of the increasing burden of taxation and of the Federal income-tax law, which now furnishes an additional draft upon net earnings. *this exemption is likely to prove of material importance, since it amounts to an exemption of a corresponding proportion of the funds of member banks from the payment of tax to which they would otherwise be subjected.* [Emhasis added.] H. Rept. No. 69, 63d *Cong.,* 1st *Sess.,* p.39

The Federal Reserve Board, of course also takes the position that dividends received by member banks on the stock of Federal Reserve Banks are exempt from State taxation, and we

understand that the Arkansas authorities recognize this position.

Section 26, which exempts Federal Land Banks from State and local taxation, reads in pertinent part as follows:

> [E]very Federal land bank . . . including the capital and reserve or surplus therein and the income derived therefrom, shall be exempt from Federal, State, municipal, and local taxation, except taxes upon real estate. . . .

The broad scope of this exemption is reflected in the Supreme Court's opinion in *Federal Land Bank v. Bismarck, supra,* which involved an attempt by the State of North Dakota to impose a sales tax upon certain building materials purchased by the Federal Land Bank of St. Paul for repair and improvement of real estate acquired through foreclosure. In deciding that the provisions of §26 were broad enough to invalidate this tax, despite the absence of a specific referral to a sales tax in §26, the Court stated in part as follows (314 U.S. at 99-100):

> The unqualified term "taxation" used in §26 clearly encompasses within its scope a sales tax such as the instant one, and this conclusion is confirmed by the structure of the section. In reaching an opposite conclusion the court below ignored the plain language, "That every Federal land bank . . . shall be exempt from Federal, State, municipal, and local taxation," and seized upon the phrase, "including the capital and reserve or surplus therein and the income derived therefrom," as delimiting the scope of the exemption. The protection of §26 cannot thus be frittered away. We recently had occasion, under other circumstances, to point out that the term "including" is not one of all-embracing definition, but connotes simply an illustrative application of the general principle. If the broad exemption accorded to "every Federal land bank" were limited to the specific illustrations mentioned in the participial phrase introduced by "including," there would have been no

necessity to except from the purview of §26 the real estate held by the land banks.

* * *

Nothing in the legislative history of §26 commands a contrary result; and a broad construction is indicated by Congress's intention to advance credit to farm borrowers at the lowest possible interest rate. The legislative history of similar exemption clauses in other statutes supports our interpretation of §26 [citations and footnotes omitted].

Similarly, in the landmark case of *Laurens Federal Savings and Loan Association v. South Carolina Tax Commission, 365 U.S. 517 (1961), the Supreme Court broadly construed the exemption from State taxation granted by* §13. In that case, the State of South Carolina attempted to impose a documentary stamp tax upon promissory notes executed by the association evidencing loans it had received from the Federal Home Loan Bank of Greensboro (now Atlanta). The Supreme Court of South Carolina affirmed the State's taxing power on the ground that although §13 completely exempted such loans from State taxation, it did not "cover the stamp tax on the promissory notes securing the loans because these taxes were imposed upon the borrowing Association rather than upon the lending . . . Bank" and, therefore, such tax was not a tax on the Bank's loans within the meaning of §13. In rejecting this contention and declaring the tax invalid, the United States Supreme Court held that the issue had been resolved by its decision in *Pittman v. Home Owners' Loan Corporation,* 308 U.S. 21 (1939), a case in which the Court declared a Maryland stamp tax upon mortgages executed in favor of the HOLC to be a tax upon its loans which were exempted from taxation by §4(c) of the Home Owners' Loan Act of 1933. As the Supreme Court viewed the issue in *Laurens,* the South Carolina tax constituted a pro-

hibited tax on Bank advances, and it was of "no determining significance" that the tax was paid by the borrowing association rather than the lending Bank. The Court stated (365 U.S. at 519-521):

> The first question is whether the immunity granted "advances" of the Federal Home Loan Bank by the 1932 Act is broad enough to bar state stamp taxes on this loan transaction. We decided a very similar question in *Pittman v. Home Owners' Loan Corp.*, 308 U.S. 21. . . .
>
> * * *
>
> The state court in the present case, although drawing no disctinction between the terms "loans" and "advances," nevertheless thought the *Pittman* decision inapplicable here because in that case the mortgage was presented for recording by the exempt lender itself (the Home Owners' Loan Corporation) while here the South Carolina tax was assessed against the borrowing petitioner association rather than against the exempt lender (the Home Loan Bank). We distinctly said in *Pittman*, however, that the fact that the state taxing statute did not require payment of the tax by the lender has "no determining significance," our reason being that "'whoever pays it it is a tax upon the mortgage and that is what is forbidden by the law of the United States.'" We went on in *Pittman* to recognize that the real question was whether the "critical term . . . *'loans'* . . . should be construed as covering the entire process of lending, the debts which result therefrom and the mortgages given . . . as security." The question here is the same as to the synonymous term "advances" and as to the promissory notes securing the advances, since the language of the exemption is equally broad. . . . [footnotes omitted].

While the Court was of the opinion that the exemption provisions of §13 were sufficiently broad to bar the tax in question, as indicated above, it noted further that the tax contravened the

basic Congressional purpose in "insulating" Bank advances from State taxation (365 U.S. at 521, 522):

> While the question of the breadth of the exemption of "advances" in the 1932 Act thus is persuasively answered by our reasoning in *Pittman*, the same conclusion is called for by the language and legislative history of that Act as a whole. It set up a system of federally chartered Home Loan Banks for the purpose, as stated in the House and Senate Committee Reports, of placing "long-term funds in the hands of local institutions" in order to alleviate the pressing need of home owners for "low-cost, long-term, installment mortgage money" and to "decrease costs of mortgage money" with a "resulting benefit to home ownership in the form of lower costs and more liberal loans." It is to this end that the Act authorizes the Federal Home Loan Banks to make "advances" of funds to eligible borrower institutions "upon the note or obligation" of the borrower secured primarily by mortgages on homes. The exemption of these "advances" from taxation obviously is in keeping with the Act's overall policy of making these mortgage funds available at low cost to home owners. Regardless of who pays the documentary stamp taxes here at issue, the necessary effect of the taxes is to increase the cost of obtaining the advances of funds from the Home Loan Bank to be used in making loans to home owners. In this impact, therefore, this tax, whether nominally imposed on the Bank or on the petitioner, is bound to increase the cost of loans to home owners and thus contravene the basic purpose of Congress in insulating these advances from state taxation. . . . [footnotes omitted].

In our opinion, the Supreme Court's view of the State tax sought to be imposed in *Laurens* is equally applicable to the attempt by the State of Arkansas to tax dividends on Federal Home Loan Bank stock held by member associations located in that State. Ownership of such stock is not voluntary but, on the

contrary, is a condition of membership the the Federal Home Loan Bank System. By statutory definition (§2(4) of the Bank Act), a Federal Home Loan Bank member is an "institution which has subscribed" for Bank stock. Section 6(c) of the Act provides a formula for the amount of stock each member must own and maintain as long as it retains Bank membership. This amount, in turn, is directly related to the member's advances (§6(c)(2)(ii)) and, under §10(c) of the Act, each Bank has a statutory lien on the stock issued to borrowing members as security for its advances. The stock is, therefore, an integral part of the entire advance mechanism of the Banks.

Moreover, payment of dividends on the outstanding capital stock of a Federal Home Loan Bank represents, in essence, a distribution of the income of the Bank (§16 of the Bank Act). And in the words of the Supreme Court in the *Laurens* case, it is of "no determining significance" whether the tax on such income is paid by the Bank or by a member savings and loan association. Further, to paraphrase the language used by the Court, "whoever pays it it is a tax upon the [income of a Federal Home Loan Bank] and that is what is forbidden by the law of the United States". 365 U.S. at 520. Therefore, consistent with the rationale of the *Laurens* opinion and the Congressional intent manifested in §7 and its legislative history (there being no legislative history of §13 should, in our view, be broadly construed to include dividends paid to member associations on their holdings of capital stock issued by the Federal Home Loan Banks.

Additional evidence of the Congressional intent to exempt such dividends from State taxation is provided by reference to 31 U.S.C. 742(a) (as amended by §6 of the Public Debt Act of

1942, effective as of March 28, 1942).[3] Among other things, §742(a) removes the Federal (but not the State) tax exemption from "dividends, earnings, or other income from shares, certificates, stock, or other evidences of ownership" issued on or after March 28, 1942, "by the United States or any agency or instrumentality thereof". That the term "instrumentality" of the United States as used in this section applies to Federal Home Loan Banks, is not open to question (*Fahey v. O'Melveny & Meyers, supra,* 200 F.2d at 446-447), and the language of §742(a) manifests the clear Congressional understanding that the §13 tax exemption includes dividends paid on the capital stock issued by the Banks.[4] The Internal Revenue Service—the

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[3] As amended on March 28, 1942, said section 742(a) read in part as follows:

> "(a) *Interest upon* obligations, and *dividends, earnings, or other income from shares, certificates, stock, or other evidences of ownership,* and gain from the sale or other disposition of such obligations a. [4] evidences of ownership *issued on or after the effective date of the Public Debt Act of 1942 by the United States or any agency or instrumentality thereof shall not have any exemption, as such,* and loss from the sale or other disposition of such obligations or evidences of ownership shall not have any special treatment, as such, *under Federal Tax Acts now or hereafter enacted. . . .* " [Emphasis added]

A 1947 Amendment to §742(a) substituted the phrase "under the Internal Revenue Code . . . " for "Federal Tax Acts now or hereafter enacted"; and in 1959, this language was changed to its present style to specify the "Internal Revenue Code of 1954". See the notes to 12 U.S.C.A. 742(a). However, neither amendment referred to or removed the State tax exemption.

[4] In this regard, Senate Report No. 1173, 77th Cong., 2d Sess., explains that (p.3):

> The Public Debt Act of 1941 removed the tax-exemption privilege from obligations issued by the United States and agencies and instrumentalities of the United States after the effective date of that act but the tax-exemption privilege enjoyed by shares and other evidences of ownership issued by the various agencies and instrumentalities of the United States was overlooked. The bill [H.R. 6691 which was enacted as the Public Debt Act of 1942] would remove the tax-exemption

Federal agency most directly concerned—also takes this position with respect to the Federal taxation of such dividends pre- or post 1942, as evidenced by the IRS regulations implementing 31 U.S.C. 742(a) (26 CFR 1.103-2). See, also, the related excerpts published by the Commerce Clearing House, a nationally recognized Federal tax reporter (751 CCH—Standard Federal Tax Reports, pp. 14, 128-14,130), copies of which are enclosed for your information.

For the foregoing reasons it is, therefore, our opinion that dividends on Federal Home Loan Bank stock paid to member associations located in the State of Arkansas are not includable in their gross income for State tax purposes.

Sincerely,

S/S Charles E. Allen

Charles E. Allen
General Counsel

Enclosures

Footnote 4 continued:

privilege on the shares of stock and other evidences of ownership hereafter issued by such agencies and instrumentalities. Some of the organizations the shares of which would be affected by this change are the Federal savings and loan associations, the Federal Reserve banks, the national mortgage associations, the Federal land banks, the national farm loan associations, and the Federal intermediate credit banks. This provision would not in any way affect the status for tax purposes of any agency or instrumentality of the United States.

APPENDIX G

Title 68 Oklahoma Statutes §2353:

10. "Taxable income" with respect to any taxpayer means the "taxable income," "life insurance company taxable income," "mutual insurance company taxable income," "regulated investment company taxable income," "real estate investment trust taxable income," and "cooperatives' taxable income" and any other "taxable income" as defined in the Internal Revenue Code as applies to such taxpayer or any income of such taxpayer; provided, in the case of income derived from oil and gas well production, any taxpayer, at his option, may deduct as an allowance for depletion, in lieu of other calculation of depletion based on the cost of the oil and gas deposit, twenty-two percent (22%) of the gross income derived from the properties during the taxable year, but such allowance shall not exceed fifty percent (50%) of the net income of the taxpayer (computed without allowance for depletion) from the property; if a depletion allowance is allowed as a deduction in arriving at the adjusted gross income in the case of an individual, or taxable income for corporations and trusts or distributable income of partnerships by the Internal Revenue Service, the percentage depletion so calculated shall in no event be a duplication of depletion allowed on the Federal Income Tax Return;

11. "Adjusted gross income" means "adjusted gross income" as defined in the Internal Revenue Code;

12. "Oklahoma taxable income" means "taxable income" as reported (or as would have been reported by the taxpayer had a return been filed) to the federal government, and in the event of adjustments thereto by the federal government as finally ascertained under the Internal Revenue Code, adjusted further as hereinafter provided;

13. "Oklahoma adjusted gross income" means "adjusted gross income" as reported to the federal government (or as would have been reported by the taxpayer had a return been filed), or in the event of adjustments thereby by the federal government as finally ascertained under the Internal Revenue Code, adjusted further as hereinafter provided; . . .

APPENDIX H

12 USC §1433. Exemption from taxation; obligations acceptable as credit on debt of home owner

Any and all notes, debentures, bonds, and other such obligations issued by any bank, and consolidated Federal Home Loan Bank bonds and debentures, shall be exempt both as to principal and interest from all taxation (except surtaxes, estate, inheritance, and gift taxes) now or hereafter imposed by the United States, by any Territory, dependency, or possession thereof, or by any State, county, municipality, or local taxing authority. The bank, including its franchise, its capital, reserves, and surplus, its advances, and its income shall be exempt from all taxation now or hereafter imposed by the United States, by any Territory, dependency, or possession thereof, or by any State, county, municipality, or local taxing authority; except that [in] any real property of the bank shall be subject to State, Territorial, county, municipal, or local taxation to the same extent according to its value as other real property is taxed. The notes, debentures, and bonds issued at any bank, with unearned coupons attached, shall be accepted at par by such bank in payment of or as a credit against the obligation of any home-owner debtor of such bank.

APPENDIX I

31 USC §742. Exemption from taxation

All stocks, bonds, Treasury notes, and other obligations of the United States, shall be exempt from taxation by or under State or municipal or local authority. This exemption extends to every form of taxation that would require that either the obligations or the interest thereon, or both, be considered, directly or indirectly, in the computation of the tax, except nondiscriminatory franchise or other nonproperty taxes in lieu thereof imposed on corporations and except estate taxes or inheritance taxes.

31 USC §742a. Application of other laws

(a) Exemption from taxation under Internal Revenue Code; exceptions. Interest upon obligations, and dividends, earnings, or other income from shares, certificates, stock, or other evidences of ownership, and gain from the sale or other disposition of such obligations and evidences of ownership issued on or after the effective date of the Public Debt Act of 1942 [enacted Mar. 28, 1942] by the United States or any agency or instrumentality thereof shall not have any exemption, as such, and loss from the sale or other disposition of such obligations or evidences of ownership shall not have any special treatment, as such, except as provided under the Internal Revenue Code of 1954 [26 USCS §§1 et seq.]; except that any such obligations which the United States Maritime Commission or the Federal Housing Administration had, prior to March 1, 1941, contracted to issue at a future date, shall when issued bear such tax-exemption privileges as were, at the time of such contract, provided in the law authorizing their issuance. For the purposes of this subsection a Territory, a possession of the United States, and the District of Columbia, and any political subdivision thereof, and any agency or instrumentality of any one or more of the forego-

ing, shall not be considered as an agency or instrumentality of the United States.

(b) Provisions of this section as amendatory and supplementary to other provisions. The provisions of this section shall, with respect to such obligations and evidences of ownership, be considered as amendatory of and supplementary to the respective Acts or parts of Acts authorizing the issuance of such obligations an evidences of ownership, as amended and supplemented.

(c) Amendment or repeal of provisions of the Revenue Act of 1941. Nothing contained herein shall be construed to amend or repeal sections 114 and 115 of the Revenue Act of 1941.

APPENDIX J

Title 68 Oklahoma Statutes §2358A.2.

2. There shall be deducted amounts included in such income that the state is prohibited from taxing because of the provisions of the Federal Constitution, the State Constitution, federal laws or laws of Oklahoma.

APPENDIX K

12 USC 1464(h)

(h) Exemptions from taxation. No state, county, municipal, or local taxing authority shall impose any tax on such associations or their franchise, capital, reserves, surplus, loans, or income greater than that imposed by such authority on other similar local mutual or cooperative thrift and home financing institutions.

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No. 82-905

In the Supreme Court of the United States

OCTOBER TERM, 1982

SOONER FEDERAL SAVINGS AND LOAN ASSOCIATION, KAY COUNTY FEDERAL SAVINGS AND LOAN ASSOCIATION, and FIRST FEDERAL SAVINGS AND LOAN ASSOCIATION OF LAWTON,
Appellants,

VERSUS

OKLAHOMA TAX COMMISSION, and THE STATE OF OKLAHOMA,
Appellees.

On Appeal From the Supreme Court of The State of Oklahoma

SUPPLEMENTAL BRIEF ON JURISDICTION

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April, 1983

QUESTIONS PRESENTED

1. Did the Supreme Court of Oklahoma err in determining that 12 U.S.C. § 1433 does not deprive the State of Oklahoma of the right to tax dividends disbursed by the Federal Home Loan Bank, pursuant to 12 U.S.C. § 1421, *et seq.*, to its stockholders, Appellants herein, as income under the provisions of the Oklahoma Income Tax Code?

2. Does 31 U.S.C. §§ 742 and 742a. provide an exemption from state taxation for dividends paid to stockholders from the net earnings of the Federal Home Loan Bank accruing as a result of the Bank's profitable operations?

DESIGNATION OF CORPORATE RELATIONSHIPS

This is its second Designation of Corporate Relationships. The Designation that was filed originally is currently accurate.

TABLE OF CONTENTS

PAGE

QUESTIONS PRESENTED i

DESIGNATION OF CORPORATE REALTIONSHIPS i

NEW CASES AND MATERIALS NOT AVAILABLE FOR INCLUSION IN THE JURISDICTIONAL STATEMENT 1

COMMENTS RELATING TO THE BRIEF FOR THE UNITED STATES AS AMICUS CURIAE SUPPORTING DISMISSAL 6

CONCLUSION 10

CERTIFICATE OF SERVICE follows Brief.

TABLE OF AUTHORITIES

Cases	PAGE(S)
First Federal Savings and Loan Association v. *Department of Revenue, et al.*, 654 P.2d 496 (Mont. 1982), *certiorari requested* (U.S. Mar. 4, 1983) (No. 82-1476)	4
Laurens Federal Savings and Loan Association v. *South Carolina Tax Commission*, 365 U.S. 517 (1961)	8
Memphis Bank & Trust Company v. *Riley C. Garner, Shelby County Trustee, et al.*, 51 U.S.L.W. 4104	2
New Jersey Realty and Title Ins. Co. v. *Division of Tax Appeals*, 338 U.S. 665 (1950)	6
Pittman v. *Home Owners' Loan Corp.*, 308 U.S. 21 (1939)	9
Smith v. *Davis*, 323 U.S. 111, 89 L.Ed. 107, 65 S.Ct. 157 (1944)	6
Statutory Provisions	
12 U.S.C. § 1421	i
12 U.S.C. § 1433	i
12 U.S.C. § 1433 (Section 13, Federal Home Loan Bank Act)	6
12 U.S.C. § 1426 (Section 6(c), Federal Home Loan Bank Act)	7
31 U.S.C. § 742	i, 2-3

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SUPPLEMENTAL BRIEF ON JURISDICTION

NEW CASES AND MATERIAL NOT AVAILABLE FOR INCLUSION IN THE JURISDICTIONAL STATEMENT

1. On the 24th day of January, 1983, the United States Law Week published on page 4104 of Volume 51, a decision by this Honorable Court styled *Memphis Bank & Trust Company* v. *Riley C. Garner, Shelby County Trustee, et al.*, Docket No. 81-1613. This decision held invalid a Tennessee bank tax which was levied on the net earnings of a bank, which earnings included interest income on obligations of states other than Tennessee as well as the United States

and its instrumentalities. This Court characterized the tax on the federal obligations as discriminatory as provided in 31 U.S.C. § 742. Consequently, the rationale and interpretation by this Court expressed in its opinion in *Memphis Bank* is applicable and controlling in this situation.

Initially, this Court in *Memphis Bank* recognized that the exemption established in 31 U.S.C. § 742 is applicable not only to such obligations as Treasury bills and notes, "but also to the obligations of such instrumentalities of the United States as Federal Credit Banks." See *Memphis Bank & Trust Co.* v. *Garner, supra,* p. 4105 (footnote 5 therein). Indeed, the opinion of this Court in *Memphis Bank* continues by holding that the immunity from taxation contained in 31 U.S.C. § 742 extends, not only to the obligation itself, but also to the income derived from the various types of federal obligations held by the Memphis Bank & Trust Co. In so holding, this Court opined at page 4105: "Because no federal statutes have 'otherwise provided', § 742 applies to income from the types of federal obligations held by Memphis Bank."

Appellants would submit that its factual situation is not significantly different from that found in *Memphis Bank* in that the *Memphis Bank* decision focused on that portion of 31 U.S.C. § 742 which prohibits all but nondiscriminatory franchise or other nonproperty taxes imposed on otherwise exempt federal obligations.[1] Appellants' situation, however,

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[1] Section 742 provides:

> All stocks, bonds, Treasury notes, and other obligations of the United States, shall be exempt from taxation by or under State or municipal or local authority. This exemption extends to every form of taxation that would require that either the obligations or the interest thereon,

is somewhat more basic for the reason that the issue here does not involve a nondiscriminatory franchise or other nonproperty tax, but encompasses a state income tax directly imposed upon the income derived from a statutorily exempt federal obligation, *i.e.*, dividends paid on Federal Home Loan Bank stock. Therefore, under this Court's rationale, outlined above, the income attributable to the dividends on Federal Home Loan Bank stock should be exempt from state taxation.

In conclusion, Appellants would argue that the statutory language of 31 U.S.C. § 742, which supported reversal of the decision of the Tennessee Supreme Court in *Memphis Bank*, is as strongly supportive of Appellants' present position as it was of the position of Memphis Bank & Trust Co. Here, as in the *Memphis Bank* case, the statute clearly and unequivocally exempts from state, municipal or local taxation "all stocks, bonds, Treasury notes, and other obligations of the United States . . ." to include, as this Court determined, the income derived from such obligations. Furthermore, there are no federal statutes which have "otherwise provided" for taxation of these obligations by state, local or municipal authority. Therefore, it is Appellants' position that the statutory language proscribes and prohibits the State of Oklahoma from imposing a state income tax on the income attributable to dividends paid to Appellants based upon their stock ownership in the Federal Home Loan Bank.

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[1] (Continued)

or both, be considered, directly or indirectly, in the computation of the tax, except nondiscriminatory franchise or other nonproperty taxes in lieu thereof imposed on corporations and except estate taxes or inheritance taxes.

2. On the 6th day of December, 1982, the Supreme Court of the State of Montana denied a Petition for Rehearing by the Department of Revenue (State of Montana), and, thereby, allowed to stand that court's previously issued opinion of September 23, 1982, in a case styled *First Federal Savings and Loan Association, et al.* v. *Department of Revenue, et al.*, 654 P.2d 496 (Mont. 1982), *certiorari requested* (U.S. Mar. 4, 1983) (No. 82-1476). In this decision, the Supreme Court of Montana held *inter alia* that income received on exempt federal obligations by the taxpayers, First Federal Savings and Loan Association, et al., was not includable in net income for purposes of calculating the Montana corporation license tax.

In the opinion cited above, the taxpayers contended as one of their positions that income derived from dividends on Federal Home Loan Bank stock, in the amount of $48,-013.00, was exempt from the Montana corporation license tax. The Montana corporation license tax imposes a tax on corporations for the privilege of doing business within the State and is levied as a percentage of corporate net income.

The basis of the taxpayers' claim was that 31 U.S.C. § 742 specifically excluded such income from state taxation. In agreeing that the dividend income in question was exempt under the provisions of 31 U.S.C. § 742, the Supreme Court of Montana held that 12 U.S.C. § 1433 and 31 U.S.C. § 742 "clearly exempt the interest income of the federal obligations involved in the instant case from the Montana corporation license tax." (See *First Federal Savings and Loan, et al.* v. *Department of Revenue, supra*, at page 499.) Moreover, the Supreme Court of Montana had no difficulty

in characterizing interest or a related type of income, such as dividends from the Federal Home Loan Bank, as being included within the exemption statutes cited above. Finally, the court concluded that the State could not tax indirectly, by redefining the basis of the tax, what it could not tax directly by virtue of the federal exemption statutes. (See *First Federal Savings and Loan, et al.* v. *Department of Revenue, supra*, at page 498.)

Appellants would submit that the *First Federal* case presents a direct conflict of authorities between the Supreme Courts of two states. Moreover, the opinions of these two State Supreme Courts clearly define a question which is ripe for decision by this Honorable Court to prevent an inconsistent application of the exemption statute by the several states, and to resolve the conflict in the interpretation of federal statutes. Appellants assert that this divergence of opinion presents a substantial federal question.

In addition, Appellants would argue that the conclusion reached in the Montana decision is the better reasoned decision, if, for no other reason, than the fact that the opinion of the Supreme Court of Oklahoma did not even consider, or otherwise note, the federal exemption contained in 31 U.S.C. § 742 despite its being relied upon and briefed by the parties. Federal statutes are not enacted by the Congress of the United States to be followed or disregarded at the whim of the several states, and the action of the Supreme Court of Oklahoma in totally ignoring a federal exemption statute with respect to exempt income items is an absolute abuse of federal law.

COMMENTS RELATING TO THE BRIEF FOR THE UNITED STATES AS AMICUS CURIAE SUPPORTING DISMISSAL

In its Brief of Amicus Curiae, the United States (A.C. footnote 2 and pages 2-4) apparently considers that Appellants are claiming that the exemption found in Section 13, Federal Home Loan Bank Act, 12 U.S.C. § 1433, applies only to *their* dividends received by virtue of their ownership of stock in the Federal Home Loan Bank. In this respect, the perception of the United States is erroneous. Appellants are claiming the exemption provided by 12 U.S.C. § 1433 against *all* state taxation of those items enumerated within the statute. Appellants submit that this statute specifically exempts all items enumerated therein as well as the income derived therefrom. See *New Jersey Realty & Title Ins. Co.* v. *Division of Tax Appeals*, 338 U.S. 665, 675-676 (1950).

In its Brief of Amicus Curiae, the United States continues by focusing this Court's attention on the fact that there is no language which exempts from taxation dividends on Federal Home Loan Bank stock (A.C. pp. 6-7). The United States points out that nothing in 12 U.S.C. § 1433 "expressly precludes the taxation by Oklahoma of dividends paid on shares of Federal Home Loan Bank stock." Indeed, Appellants would respond that, in a somewhat analogous situation, this Court has recognized:

> [The Congressional intent] . . . to prevent taxes which diminish in the slightest degree the market value or the investment attractiveness of obligations issued by the United States in an effort to secure necessary credit . . . (See *Smith* v. *Davis*, 323 U.S. 111, 117, 89 L.Ed. 107, 111, 65 S.Ct. 157 (1944).)

In constructing and enacting statutes, Congress does not and cannot envision every type of obligation that may be used by the Government or its agencies to facilitate its statutorily mandated functions. Congress, of necessity, provides only a general statutory exemption from state taxation in certain areas. Therefore, although Congress may not specifically delineate an item as being included within an exemption statute, this should by no means be regarded as an indication that Congress intended that the item was to be denied exempt status under the law. Finally, Appellants believe that while this particular statute does not expressly list, enumerate or otherwise specify the entire group of investment obligations, or income therefrom, included within the meaning of 12 U.S.C. § 1433, the language, legislative history and case law relating to this statute does indicate that taxation of these investment instruments, and the income derived therefrom, is expressly denied to the several states.

With respect to the argument that the United States does not believe that the dividends paid on shares of Federal Home Loan Bank stock are derived from earnings of the Federal Home Loan Bank (A.C. p. 7), Appellants would argue that this position is in direct contravention of basic corporate law. If the dividends paid on the stock are not directly related to the earnings of the Federal Home Loan Bank, then presumably these payments would not be characterized as "dividends", but rather as a liquidation payment with the attendant tax consequences under federal and state law. It is basic to the Federal Home Loan Bank's system that member associations subscribe and maintain shares in the Federal Home Loan Bank. [See Section 6(c) of the Federal Home Loan Bank Act.] Dividends are paid

on the basis of the number of shares held in the Federal Home Loan Bank. It is beyond Appellants' understanding that the United States could contend that these dividends are not related to the earnings of the Federal Home Loan Bank, and that state taxation of these dividends does not constitute an indirect taxation of the income of the Federal Home Loan Bank.

Finally, the United States apparently believes that the opinion of this Court in *Laurens Federal Savings and Loan Association* v. *South Carolina Tax Commission*, 365 U.S. 517 (1961), merely invalidated a state documentary stamp tax imposed on promissory notes executed by federal savings and loan associations because it was a tax on an advance made by the Federal Home Loan Bank (A.C. pp. 7-8). Appellants contend that the United States has completely misconstrued the *Laurens* opinion and this Court's interpretation of 12 U.S.C. § 1433 contained therein.

In the *Laurens* opinion, this Court held that the tax was, in effect, being levied on the advance mechanism system inherent to the Federal Home Loan Bank. In this regard, this Court observed, in connection with examining the breadth of the exemption, that:

> [The 1932 Act] . . . set up a system of federally chartered Home Loan Banks for the purpose, as stated in the House and Senate Committee Reports, of placing "long-term funds in the hands of local institutions" in order to alleviate the pressing need of home owners for "low-cost, long term installment mortgage money" and "to decrease cost of mortgage money" with a resulting benefit to homeownership in the form of lower costs and more liberal loans. See *Laurens, supra*, pp. 521-522.

As a result, the tax invalidated in the *Laurens* case was not upon the advances, as alleged by the United States, but on the entire process whereby advances were made through the system established for the Federal Home Loan Bank.

Furthermore, the United States contradicts itself in this same paragraph (A.C. pp. 7-8) when, in its discussion of this Court's Opinion in *Pittman* v. *Home Owners' Loan Corp.*, 308 U.S. 21 (1939), the United States concedes that the purchase of stock "is an integral part of the entire advance mechanism of the Federal Home Loan Bank . . ." Appellants submit that if the purchase of this stock is an integral part of the entire advance mechanism system of the Federal Home Loan Bank, then it is only logical to conclude that taxation of the dividends paid on the stock, itself, is likewise proscribed by the statute.

With respect to the arguments advanced by the United States in connection with 31 U.S.C. § 742 (A.C. pp. 9-10), Appellants would refer this Court to its discussion of recent case law cited above.

CONCLUSION

In conclusion, Appellants assert that the rationale submitted by the United States in support of its Brief of Amicus Curiae to this Court does not warrant the conclusion contained therein. Additionally, Appellants submit this case is ripe for decision, and should be accorded plenary review by this Court.

Respectfully submitted,

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April, 1983

CERTIFICATE OF SERVICE

I, E. John Eagleton, one of the attorneys for Sooner Federal Savings and Loan Association, Kay County Federal Savings and Loan Association, and First Federal Savings and Loan Association of Lawton, Appellants herein, and a member of the Bar of the Supreme Court of the United States, hereby certify that, on the ..... day of ....., 1983, I served three copies of the Supplemental Brief on Jurisdiction contained herein on the Oklahoma Tax Commission (State of Oklahoma), by mailing in a duly addressed envelope, certified mail prepaid, to Donna E. Cox, *Esq.*, Counsel for the Oklahoma Tax Commission, at the offices of the Oklahoma Tax Commission, 2501 N. Lincoln Blvd., Oklahoma City, Oklahoma 73194, and on the United States, by leaving a copy thereof at the office of Frank Keating, *Esq.*, United States Attorney for the Northern District of Oklahoma, at Room 460, Federal Building, Tulsa, Oklahoma, and by mailing a copy in a duly addressed envelope, certified mail, postage prepaid, to the Solicitor General, Department of Justice, Washington, D.C. 20530.

E. JOHN EAGLETON
Attorney for Sooner Federal Savings and Loan Association, et al.

Supreme Court, U.S.
FILED
DEC 30 1982
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No. 82-905

IN THE
Supreme Court of the United States
OCTOBER TERM, 1982

SOONER FEDERAL SAVINGS AND LOAN ASSOCIATION, KAY COUNTY FEDERAL SAVINGS AND LOAN ASSOCIATION, and FIRST FEDERAL SAVINGS AND LOAN ASSOCIATION OF LAWTON,

Appellants

v.

OKLAHOMA TAX COMMISSION, and THE STATE OF OKLAHOMA,

Appellees

On Appeal from The Supreme Court of The State of Oklahoma

MOTION TO DISMISS, OR IN THE ALTERNATIVE, MOTION TO AFFIRM

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December 1982

QUESTION PRESENTED

May a state tax dividends distributed by a federal home loan bank to a federally chartered savings and loan association?

TABLE OF CONTENTS

Page

THE QUESTION PRESENTED i

TABLE OF CONTENTS iii

TABLE OF AUTHORITIES iv

THE OPINIONS BELOW 2

THE PARTIES 2

STATEMENT OF JURISDICTION 2

THE QUESTION PRESENTED FOR REVIEW 6

STATEMENT OF THE CASE 6

APPELLEE'S ARGUMENT IN SUPPORT OF ITS MOTION TO DISMISS 9

APPELLEE'S ARGUMENT IN SUPPORT OF ITS MOTION TO AFFIRM 12

CONCLUSION 16

APPENDIX .....

TABLE OF AUTHORITIES

Cases	Page(s)
First Federal Savings and Loan Association of Boston, et al., v. State Tax Commission, et al., 437 U.S. 255, 98 S.Ct. 2333 (Mass: 1978)	1, 8, 9, 16
House v. Road Improvement District No. 2 of Conway County, Ark., et al., 45 S.Ct. 60, 266 U.S. 175 (1924)	3
McGoldrick v. Compagnie Generale Transatlantique, 60 S.Ct. 670, 672, 309 U.S. 430, 434 (1940)	3
Hamilton v. Regents of the University of California, 55 S.Ct. 197, 293 U.S. 245 (1934)	4, 5
Lathrop v. Donohue, 81 S.Ct. 1826, 367 U.S. 820, (1961)	4, 5
Tradesman National Bank v. Oklahoma Tax Commission, 309 U.S. 560, 60 S.Ct. 688 (Okl: 1940)	10
McCulloch v. Maryland, 4 Wheat. 316, 4 L.Ed. 579 (1819)	10
United States v. New Mexico, 102 S.Ct. 1373 (1982)	10, 11, 14, 16
Oklahoma Tax Commission v. Texas Co., 336 U.S. 342, 69 S.Ct. 561, (Okl: 1949)	10
Graves et al. v. People of the State of New York ex rel. O'Keefe, 306 U.S. 466, 59 S.Ct. 595 (NY: 1939)	10
Fox Film Corporation v. Doyal, 286 U.S. 123, 52 S.Ct. 546, 547 (NY: 1932)	11

Indian Motorcycle Co. v. United States, 283 U.S. 570, 576, 51 S.Ct. 601, 603, 75 L.Ed. 1277 (Mass: 1931) 11

Fahey v. Mallonee, 332 U.S. 245, 67 S.Ct. 1552 (Cal: 1947) 12

Federal Home Loan Bank of San Francisco v. O'Melveny & Myers, et al., 200 F.2d 420 (9th C.C.A.: Cal: 1952) 12

Laurens Federal Savings & Loan Association v. South Carolina Tax Commission, 365 U.S. 517, 81 S.Ct. 719, 5 L.Ed. 2d 749 (S.C.: 1961) 12, 15

Pittman v. Home Owners Loan Corporation, 308 U.S. 21, 84 L. Ed. 11 (Md: 1939) 15

Helvering v. Mountain Producers Corporation, 303 U.S. 376, 58 S.Ct. 623 (Wash: 1938) 15

Educational Films Corporation of America v. Ward, 282 U.S. 379, 51 S.Ct. 170 (NY: 1930) 15

United States Code

12 U.S.C. §1464 (h) 1, 6, 9, 12, 13, 14, 16
28 U.S.C. §1257(2) 2, 3, 4, 5, 11, 16
12 U.S.C. §1433 ..... 6, 7, 8, 9, 13, 14, 16
12 U.S.C. §1402 8
12 U.S.C. §548 10
12 U.S.C. §1461 12
12 U.S.C. §1420 12
12 U.S.C. §1426 13
12 U.S.C. §1436 13
12 U.S.C. §931 14

Oklahoma Statues

68 O.S. 1981, §105 2
68 O.S. 1971, §§227 and 228 3
68 O.S. Supp. 1974, §2358 7
68 O.S. §2351 7
68 O.S. Supp. 1980, §225 9

No. 82-905

IN THE

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SOONER FEDERAL SAVINGS AND LOAN ASSOCIATION, KAY COUNTY FEDERAL SAVINGS AND LOAN ASSOCIATION, and FIRST FEDERAL SAVINGS AND LOAN ASSOCIATION OF LAWTON,

Appellants,

v.

OKLAHOMA TAX COMMISSION, and THE STATE OF OKLAHOMA,

Appellees.

On Appeal from The Supreme Court of The State of Oklahoma

MOTION TO DISMISS OR IN THE ALTERNATIVE MOTION TO AFFIRM

Appellee, Oklahoma Tax Commission, pursuant to Rule 16 of this Honorable Court, respectfully submits that this appeal should be dismissed, or in the alternative, that the decision of Mr. Vice-Chief Justice Barnes, all other Justices concur, of the Supreme Court of the State of Oklahoma, should be affirmed. Probable jurisdiction should not be noted. The decision of the Supreme Court of the State of Oklahoma is correct. The decision held that dividends received by federally chartered savings and loan associations from a federal home loan bank are subject to state income taxation as

permitted in 12 U.S.C. §1464 (h). The decision followed the holding of this Honorable Court in *First Federal Savings and Loan Association of Boston, et al, v. State Tax Commission, et al,* 437 U.S. 255, 98 S.Ct. 2333 (Mass: 1978).

THE OPINIONS BELOW

1. Order No. 79-12-04-06 of the Oklahoma Tax Commission entered on the 4th day of December, 1979, appears at pages 11-A through 15-A of the Appendix in the Jurisdictional Statement.

2. Opinion of the Supreme Court of the State of Oklahoma entered the 5th day of October, 1982, affirming the Order of the Oklahoma Tax Commission, appears at pages 1-A through 10-A of the Appendix in the Jurisdictional Statement.

THE PARTIES

The Oklahoma Tax Commission is the Appellee. The Oklahoma Tax Commission is exclusively designated by 68 O.S. 1981, §105 to represent the interests of the State of Oklahoma in such a case.

STATEMENT OF JURISDICTION

Appellee acknowledges the jurisdiction of the United States Supreme Court to review by writ of certiorari a decision of the Oklahoma Supreme Court involving the interpretation or effect of a federal statute.

However, Appellants assert that 28 U.S.C. §1257, subsection (2) confers jurisdiction upon this Honorable Court to review the decision of the Oklahoma Supreme Court. 28 U.S.C. §1257(2) states:

"§1257. State courts; appeal; certiorari

Final judgments or decrees rendered by the highest court of a state in which a decision could be had, may be reviewed by the Supreme Court as follows:

(2) By appeal, where is drawn in question the validity of a statute of any state on the ground of its being repugnant to the Constitution, treaties or laws of the United States, and the decision is in favor of its validity."

To sustain the challenge of a state statute as repugnant to the Constitution or laws of the United States, the challenge of the state statute in the state Supreme court must be distinct and substantial. *House v. Road Improvement District No. 2 of Conway County, Ark., et al.*, 45 S.Ct. 60, 266 U.S. 175 (1924). In the instant case, Appellants failed to attack the validity of a state statute before the Oklahoma Supreme Court and the Oklahoma Tax Commission and are without jurisdictional grounds to question the validity of a statute on an appeal to the United States Supreme Court.

"(I)t is . . . the settled practice of this Court (U.S. Supreme Court), in the excercise of its appellate jurisdiction, that it is only in exceptional cases, and then only in cases coming from the federal courts, that it considers questions urged by a petitioner or appellant not pressed or passed upon in the courts below." *McColdrick v. Compagnie Generale Transatlantique*, 60 S.Ct. 670, 672, 309 U.S. 430, 434 (1940).

Appellants did not attack the provisions of the Oklahoma income tax laws in their protest filed pursuant to 68 O.S. 1971, §227 and 228, nor in the Petition in Error to

the Oklahoma Supreme Court. Appellants' Protest and Petition in Error are set out in full in the Appendix.

Appellants generally attacked the administration of the tax laws in Proposition III of their initial brief to the Supreme Court of Oklahoma, arguing that an administrative finding that dividends paid to a savings and loan association on their stock in the federal home loan bank are taxable income is in violation of constitutional and statutory provisions. Such an argument does not attack the validity of the state statute in a distinct and substantial manner.

Further, an administrative order may be considered a "statute" for jurisdictional purposes under 28 U.S.C. 1257 (2) if it is legislative in nature. *Hamilton v. Regents of the University of California*, 55 S.Ct. 197, 293 U.S. 245 (1934). In *Hamilton* an order was issued by a land grant state university requiring compulsory military training. The Court, in finding that the order was indeed a "statute" as applies to "statute of any state", held at page 202 that:

> "The assailed order prescribes a rule of conduct, and applies to all students belonging to the defined class .... The meaning of "statute of any state" is not limited to acts of state Legislatures. It is used to include every act legislative in character to which the state gives sanction, no distinction being made between acts of the state Legislature and other exertions of the state lawmaking power."

In the case of *Lathrop v. Donohue*, 81 S.Ct. 1826, 367 U.S. 820, (1961), the Court again discussed what "statute" means within the phrase "statute of any state" as used in 28 U.S.C. §1257 (2). *Lathrop* dealt with the question of whether an order of the Wisconsin Supreme

Court integrating the Wisconsin Bar was a statute as called for at 28 U.S.C. §1257 (2). The Court in *Lathrop* based their definition of statute on whether the order was adjudicatory or legislative in nature. The Court at page 1829 held that:

> "Integration of the Bar in Wisconsin bore no resemblance to adjudication. . . . (T)he court sought to regulate the profession by applying its orders to all present members of the Bar and to all persons coming within the described class in the future. As such, the action had the characteristics of legislation."

The Court in *Lathrop*, found that the order was legislative in nature and within the meaning of "statute" in 28 U.S.C. §1257 (2).

In the case at bar the administrative order is adjudicatory in nature, issued on an individual taxpayer's protest proceeding. The Oklahoma Tax Commission's Order does not prescribe a rule of conduct for a class of individuals as called for in the *Hamilton* and *Lathrop* cases. The Order was issued after the administrative hearing at which evidence was presented and a finding was made as to the particular facts involved. As such, it is an adjudicatory order which does not fall within the meaning of a "statute" under 28 U.S.C. §1257 (2).

Further, the Questions Presented at page -i- of the Jurisdictional Statement do not question the validity of a state statute.

Wherefore, Appellee respectfully submits that Appellants have failed to establish a jurisdictional basis for review by appeal of the decisions of the Oklahoma Supreme Court rendered October 5, 1982.

THE QUESTION PRESENTED FOR REVIEW

The Supreme Court of the State of Oklahoma affirmed the Order of the Oklahoma Tax Commission denying a refund of state income tax paid by Appellants. In affirming the Order of the Oklahoma Tax Commission, the Oklahoma Supreme Court recognized the Congressional permission to the state to levy and enforce a non-discriminatory income tax on federally chartered savings and loan associations in 12 U.S.C. §1464 (h), which provides:

> "No state, county, municipal or local taxing authority shall impose any tax on such associations or their franchise, capital, reserves, surplus, loans, or income greater than that imposed by such authority on other similar local mutual or cooperative thrift and home financing institution."

The Oklahoma Supreme Court did not agree with Appellants' main contention that 12 U.S.C. §1433 exempts from state taxation dividends on stock issued by Federal Home Loan Banks. The Oklahoma Court found that §1433, supra, by its very language, exempts the Federal Home Loan Bank from state taxation and in no way refers to the federally chartered savings and loan associations.

Therefore, the question presented in this case is:

Whether subsection (h) of 12 U.S.C. §1464 permits Oklahoma to tax dividends disbursed by a Federal Home Loan Bank to its stockholders, Appellant, savings and loan associations, as income of said stockholders?

STATEMENT OF THE CASE

This case involves the administration of a state tax statute. Appellants do not attack the constitutionality or validity of a state statute. Rather, Appellants claim an exemption from state taxation under both federal and state statutes, 12 U.S.C. §1433 and 68 O.S. Supp. 1974, §2358, subsection A.2., which provides:

> "A. Taxable income and, where use of adjusted gross income is necessary, i.e., required by this act, adjusted gross income shall be adjusted as follows to arrive at Oklahoma taxable income and Oklahoma adjusted gross income:
>
> * * *
>
> "2. There shall be deducted amounts included in such income amounts that the state is prohibited from taxing because of the provisions of the Federal Constitution, the State Constitution, federal laws or laws of Oklahoma. . . ."

All the facts were presented to the Oklahoma Tax Commission, the administrative tribunal, upon stipulation, as follows:

(1) The claimants (Appellants) are federally chartered savings and loan associations.

(2) Claimants (Appellants) are required to own stock in the Federal Home Loan Bank as a condition of membership in the Federal Home Loan Bank system.

(3) The claimants (Appellants) received dividends on the Federal Home Loan Bank Stock owned by them in the years 1972, 1973 and 1974 and subsequent income tax years.

(4) Claimants (Appellants) voluntarily reported and paid Oklahoma corporation income taxes on said dividends under the "Oklahoma Income Tax Code", §2351 et seq., of Title 68, Oklahoma Statutes, in the total amount, for Oklahoma corporation income tax years 1972, 1973 and 1974, of $13,802.12, which taxes are claimed by the State solely by virtue of the dividends received by these associations on the Federal Home Loan Banks Stocks owned by the respective claimants.

(5) The Federal Home Loan Bank in which claimants (Appellants) own stock is organized and exists by virtue of an act of Congress, the Federal Home Loan Bank Act, 12 U.S.C., §1402 et seq.

(6) That the Congressional history of 12 U.S.C. §1433 reveals that the section was enacted to provide funds more cheaply to home buyers.

(7) Section 6(c) of the Federal Home Loan Bank provides a formula for the amount of stock each member association must own and maintain as long as it retains bank membership, which amount is directly related to the members' advances, i.e., as the amount of stock paid in by member associations increases, its maximum amount of aggregate outstanding stock increases.

A copy of the 1975 letter from the General Counsel for the Federal Home Loan Bank Board, set out at pages 21-A through 32-A of the Appendix of the Jurisdictional Statement was offered and admitted into the record at the administrative hearing. Same has been superceded by the decision in *First Federal Savings and Loan Association of Boston, et al. v. State Tax Commission, et al.*, supra.

The Oklahoma Tax Commission denied Appellants' claim that dividends disbursed by a Federal Home Loan Bank to its stockholders were exempt from state taxation by 12 U.S.C. §1433, by Order No. 79-12-04-06 (Appellants' Appendix, pages 11-A through 15-A).

Upon appeal, pursuant to 68 O.S. Supp. 1980, §225, the Oklahoma Supreme Court affirmed the administrative ruling.

APPELLEE'S ARGUMENT IN SUPPORT OF ITS MOTION TO DISMISS

The issue presented is not novel or one of first impression. The issue can be stated in three prongs, to-wit:

1. Does 12 U.S.C. §1464 permit state taxation of the income of federal savings and loan associations notwithstanding 12 U.S.C. §1433?

2. Do the dividends distributed by a federal home loan bank retain the color of net income of the federal home loan bank? and,

3. Are the dividends distributed by a federal home loan bank income to the savings and loan associations?

The United States Supreme Court decisions have settled all of these aspects of this case. In *First Federal Savings and Loan Association of Boston, et al. v. State Tax Commission, et al.*, supra, a state tax measured by net operating income on federal savings and loan associations was challenged. In holding in favor of the state taxing authority, the United States Supreme Court went directly to the issue of the non-discriminatory taxation aspect of §1464(h), supra, thereby treating §1464(h) as congressional consent to state taxation of

the income of federal savings and loan associations. The Court thus answered the first prong of the issue in the affirmative.

Also, it should be noted that in *Tradesman National Bank v. Oklahoma Tax Commission*, 309 U.S. 560, 60 S.Ct. 688 (Okl: 1940), dividends distributed by a federal reserve bank to its stockholders were included in the tax computation and the Court upheld such inclusion under 12 U.S.C. §548 as a non-discriminatory tax.

The distributed dividends do not retain the protective cloak of net income of the Federal Home Loan Bank. And, Appellants' contention that a tax on the dividend income of federally chartered savings and loan associations constitutes taxation of the net income of the Federal Home Loan Bank rejects the case law restricting the doctrine of *McCulloch v. Maryland*, 4 Wheat. 316, 4 L.Ed. 579 (1819). This Honorable Court clearly limited and strictly confined the grasp of the *McCulloch* doctrine to those instances where the taxpayer actually stands in the Government's shoes, in *United States v. New Mexico*, 102 S.Ct. 1373 (1982). This confinement is based upon a long line of United States Supreme Court decisions allowing nondiscriminatory state taxation. In *Oklahoma Tax Commission v. Texas Co.*, 336 U.S. 342, 69 S.Ct. 561, (Okl: 1949) the Supreme Court restricted the rule of constitutional immunity of federal instrumentalities so as not to protect non-Indian lessees of mineral rights in allotted and restricted Indian lands from nondiscriminatory gross production tax. *Graves et al. v. People of State of New York ex rel. O'Keefe*, 306 U.S. 466, 59 S.Ct. 595 (NY: 1939), held that the governmental immunity from taxation, as a principle of constitutional construction, should be narrowly restricted and does not prohibit a nondis-

criminatory state income tax upon the salary of an employee of the Federal Home Owners' Loan Corporation.

Thus, the distributed dividends from the Federal Home Loan Bank do not remain protected from state taxation as the net income of a federal instrumentality.

Upon distribution, the dividends are owned by the federal savings and loan associations and are income to the associations. In *Fox Film Corporation v. Doyal*, 286 U.S. 123, 52 S.Ct. 546, 547 (NY: 1932), the issue of state tax on copyrights was before the Court. The Court, in holding in favor of the state taxing authority, quoted *Indian Motorcycle Co. v. United States*, 283 U.S. 570, 576, 51 S.Ct. 601, 603, 75 L.Ed. 1277 (Mass: 1931) wherein the immunity under *McCulloch*, supra, was held not to extend to "anything lying outside or beyond governmental functions and their exertion." The *Fox*, supra, decision states at p.547:

> "... The property of the United States is not subject to state taxation (Van Brocklin v. Tennessee, 117 U.S. 151, 6 S.Ct. 670, 29 L.Ed. 845), but the property of individual owners, although derived from the United States under its public land laws, may be taxedx. *The power to tax exists as soon as the ownership is changed*.. ..." (Emphasis Added)

Wherefore, Appellee respectfully requests this Honorable Court to dismiss the appeal of Appellants. Appellants have not established jurisdiction for review by appeal under 28 U.S.C. 1257 (2). Appellants seek review of settled issues.

APPELLEE'S ARGUMENT IN SUPPORT OF ITS MOTION TO AFFIRM

The decision of the Supreme Court of the State of Oklahoma herein recognizes the distinctions, between the Home Owners Loan Act of 1933 and the Federal Home Loan Bank Act, for purposes of state taxation, and should be affirmed by this Honorable Court.

The Home Owners' Loan Act of 1933, 12 U.S.C. §1461 et seq., provided for the establishment of federal savings and loan associations to conduct limited public banking business. *Fahey v. Mallonee*, 332 U.S. 245, 67 S.Ct. 1552 (Cal: 1947). The Federal Home Loan Bank Act, 12 U.S.C. 1420 et seq., provided a national reserve banking system for the federal savings and loan associations and other similar member and nonmember qualifying financial institutions. *Federal Home Loan Bank of San Francisco v. O'Melveny & Myers, et al.*, 200 F.2d 420 (9th C.C.A.: Cal: 1952). These Acts, designed to provide greater supply and flow of low-cost funds for home financing, were enacted within one year of each other based upon the same congressional hearings. *Laurens Federal Savings & Loan Association v. South Carolina Tax Commission*, 365 U.S. 517, 81 S.Ct. 719, 5 L.Ed. 2d 749 (S.C.: 1961). These two Acts, when read together present a unitary scheme to meet a public need. From these two Acts, the income producing aspects of the savings and loan associations and the authority of the states to tax such income within the overall scheme is apparent.

12 U.S.C. §1464, which authorizes the organization of federally chartered savings and loan associations and mandates automatic membership of the associations in a Federal Home Loan Bank, also permits the several states to impose a tax upon the income of the associations, to wit:

"12 U.S.C. §1464(h)

No state, county, municipal, or local taxing authority shall impose any tax on such associations on their franchise, capital, reserves, loans, or income greater than that imposed by such authority on other similar local mutual or cooperative thrift and home financing institutions."

12 U.S.C. §1426, which authorizes the issuance of stock, inter alia, by a Federal Home Loan Bank, provides for the distribution of dividends, to wit:

"12 U.S.C. §1426 (k)

All stock of any Federal Home Loan Bank shall share in dividend distributions without preference."

12 U.S.C. 1433 which exempts the Federal Home Loan Banks from state taxation, states in part:

"The bank, including *its* franchise, *its* capital, reserves, and surplus, its advances and *its* income, shall be exempt from all taxation. . . ." (Emphasis Added)

And, 12 U.S.C. §1436 places certain reserve and charge-off limitations on distribution of dividends by a Federal Home Loan Bank, to wit:

"12 U.S.C. §1436

. . . No dividends shall be paid except out of net earnings remaining after all reserves and charge-offs required under this chapter have been provided for, . . ."

Thus, the scheme of these acts include an intent that federally chartered savings and loan associations

should enjoy dividend income from the Federal Home Loan Bank stock paid without preference out of net earnings of the Federal Home Loan Bank, and that the savings and loan associations should pay state tax imposed in a nondiscriminatory manner on their respective incomes. In enacting these Acts, Congress did not declare the federally chartered savings and loan associations to be federal instrumentalities nor did it grant an exemption of dividend income from state taxation. Instead it enacted §1433, supra, revealing the awareness of Congress of the need to expressly protect its purely governmental entities from state taxation. Section 1433, supra, protecting the Federal Home Loan Bank, does not expressly include the income of federally chartered savings and loan associations in the tax immunization, as 12 U.S.C. §931, includes every National Farm Loan Association. And the Oklahoma Supreme Court refused to extend §1433, supra, to prohibit the states from taxing these dividends in the hands of federal savings and loan associations, as urged by Appellant. Such a construction would render §1464 (h) nugatory and disregard the decision in *United States v. New Mexico*, supra.

Appellants have not asserted that the Oklahoma income tax laws are administered in a discriminatory manner, nor do they deny that their incomes, other than from Federal Home Loan Bank stock, are subject to state taxing powers as are other similar financial institutions located within Oklahoma. Instead, they assert that the Oklahoma Supreme Court avoided a 1975 opinion of the General Counsel of the Federal Home Loan Bank Board and the opinions in *Pittman v. Home Owners Loan Corporation*, 308 U.S. 21, 84 L.Ed. 11 (Md: 1939) and *Laurens Federal Savings and Loan*

Association v. South Carolina Tax Commission, 365 U.S. 548, 89 L.Ed. 1171 (S.C.: 1961).

These two cases held that a state tax levied upon either a federal home loan bank or an intermediary for the recording of mortgages or executing of notes was invalid as being a tax on a government instrumentality. In both cases, the Court considered the taxed activities to be indispensable elements of the lending operation required for the protection of the lending institution.

The Oklahoma income tax is not upon advances, which was the situation in *Pittman*, supra, nor is it a tax on promissory notes executed by member banks thus affecting the basic functions of the home loan bank, as was the situation in *Laurens*, supra. The Oklahoma income tax does not, in any way, interfere with any of the indispensable elements of the claimant lending institutions. Nor does the Oklahoma tax interfere with the basic reason for the exemption, as manifested by the "Act's overall policy of making... mortgage funds available at low costs to home owners," as in the *Laurens*, supra, case. Also see: *Helvering v. Mountain Producers Corporation*, 303 U.S. 376, 58 S.Ct. 623 (Wash: 1938) and *Educational Films Corporation of America v. Ward*, 282 U.S. 379, 51 S.Ct. 170 (NY: 1930).

The decisions in *Pittman*, supra, and *Laurens*, supra, were based on the legislative intent of the Act which was to provide low cost home loans. The dividends in this case are paid out of surplus earned from the lending of low cost home loans.

The decision on appeal herein follows the opinions of the United States Supreme Court in *First Federal Savings and Loan Association of Boston, et al. v. State Commission, et al.*, supra, in holding the questioned

dividends subject to state taxation under 12 U.S.C. 1464 (h) and in *United States v. New Mexico*, supra, in refusing to declare Appellants exempt from state taxation as federal instrumentalities.

Wherefore, Appellee respectfully requests this Honorable Court, in the alternative, to affirm the unanimous decision of the Supreme Court of the State of Oklahoma, thus clarifying that 12 U.S.C. §1433 specifically exempts income of a Federal Home Loan Bank from state taxation and 28 U.S.C. §1464 (h) authorizes nondiscriminatory state taxation of federally chartered savings and loan associations, including dividends received from the Federal Home Loan Banks.

CONCLUSION

Appellee respectfully submits that this appeal should be dismissed for lack of jurisdiction under 12 U.S.C. §1257 (2) or because the issues involved are settled by prior decisions of this Court; or, in the alternative, the decision of the Supreme Court of Oklahoma should be affirmed without further review.

Respectfully submitted,

J. Lawrence Blankenship
General Counsel
by Donna E. Cox

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(405) 521-3141

Attorneys for Appellee
Oklahoma Tax Commission

December 28, 1982

June 17, 1976

Mr. Kenneth H. Thomason, Director
Income Tax Division
Oklahoma Tax Commission
2501 Lincoln Blvd.
Oklahoma City, Oklahoma 73194

Re: File # 758629 1972 RBM
File # 777403 1973 RBM
File # 708843 1974 RBM

Sooner Federal Savings & Loan Assoc.

Dear Ken:

You have previously sent to Sooner Federal Savings and Loan Association your denial of their protest as it relates to the taxability of dividend income received by the taxpayer's from the Federal Home Loan Bank stock.

Previously we have forwarded to you authority for the non-taxability of these dividends, to-wit: §13 of the Federal Home Loan Bank Act, Public Law 304; 47 Statute 725, 12 USC 1421 et seq. This section specifically states that:

"Any and all notes, debentures, Bonds and other such obligations issued by any bank, and consolidated Federal Home Loan Bank bonds and debentures shall be exempt both as to principal and interest from all taxation . . . The Bank, including its franchise, its capital, reserves, and surplus, its advances, *AND ITS INCOME* shall be exempt from all taxation now or hereafter imposed by the United States, by an Territory, dependency, or possession thereof, or by *ANY STATE,* county, municipality, or local taxing authority;

This section has been interpreted in General Counsel's (Federal Home Loan Bank Board) opinion dated October 29, 1975, to-wit:

> "Dividends on Federal Home Loan Bank Stock paid to member associations are not subject to State Income Taxes."

In the light of §13 and the General Counsel's memorandum opinion, the Taxpayers do hereby protest the proposed deficiency assessment for the years 1972, 1973 and 1974 and respectfully request a hearing before the Oklahoma Tax Commission.

This protest should also incorporate the proposed deficiencies against:

First Federal Savings & Loan Association of Lawton

File # 755261 RBM 1972
File # K01048 1973
File # 706145 1974, and

Kay County Federal Savings and Loan

File # 752791 1972 RBM
File # 769134 1973 RBM
File # 700468 1974 RBM

Your prompt setting of this matter before the Tax Commission will be appreciated.

Yours very truly,

E. JOHN EAGLETON
Attorney

EDWARD L. JACOBY
Attorney

IN THE SUPREME COURT OF
THE STATE OF OKLAHOMA

SOONER FEDERAL SAVINGS & LOAN ASSOCIATION, KAY COUNTY FEDERAL SAVINGS & LOAN ASSOCIATION AND FIRST FEDERAL SAVINGS & LOAN ASSOCIATION OF LAWTON:;

Plaintiffs,

vs

OKLAHOMA TAX COMMISSION, and THE STATE OF OKLAHOMA,

No. _____

Defendants.

PETITION IN ERROR

Plaintiffs in Error, Sooner Federal Savings & Loan Association, Kay County Federal Savings & Loan Association and First Federal Savings & Loan Association of Lawton, for their Petition In Error, respectfully show the Court as follows:

(a) This appeal is taken from Order No. 79-12-04-06 of the Oklahoma Tax Commission dated and mailed the 4th day of December, 1979.

(b) The style of the Oklahoma Tax Commission case was:

IN THE MATTER OF THE PROTEST OF SOONER FEDERAL SAVINGS AND LOAN ASSOCIATION,

KAY COUNTY FEDERAL SAVINGS & LOAN ASSOCIATION AND FIRST FEDERAL SAVINGS & LOAN ASSOCIATION OF LAWTON TO THE DENIAL OF CLAIMS FOR REFUNDS OF INCOME TAXES.

No. P-77-014 or P-79-014

(c) Plaintiffs in Error appeal from the Commission's Order in favor of the State of Oklahoma and denying Plaintiffs in Error request for a refund of income taxes for the years 1972, 1973 and 1974.

(d) The issue of law to be argued as error is whether the State of Oklahoma may tax dividends received by the Plaintiffs in Error on stock held by said Plaintiffs in the Federal Home Loan Bank.

(e) Plaintiffs in Error request that this Court reverse the Order of the Oklahoma Tax Commission and enter a Judgment finding that dividends from Federal Home Loan Bank Stock are exempt from taxation by the State of Oklahoma and that the Plaintiffs in Error are entitled to a cumulative tax refund of Thirteen Thousand Eight Hundred, Two and 12/100 DOLLARS ($13,802.12) for the years 1972, 1973 and 1974 plus statutory interest thereon.

(f) Petitioners in Error contend that the taxation, by the State of Oklahoma, of the Federal Home Loan Bank dividends violates Title 68 O.S. §2358A(2) and further violates Title 12 U.S.C. §1433 and Title 31 U.S.C. § 742.

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In the Supreme Court of the United States

OCTOBER TERM, 1982

SOONER FEDERAL SAVINGS AND LOAN ASSOCIATION, KAY COUNTY FEDERAL SAVINGS AND LOAN ASSOCIATION, AND FIRST FEDERAL SAVINGS AND LOAN ASSOCIATION OF LAWTON, APPELLANTS

v.

OKLAHOMA TAX COMMISSION AND THE STATE OF OKLAHOMA

ON APPEAL FROM THE SUPREME COURT OF OKLAHOMA

BRIEF FOR THE UNITED STATES AS AMICUS CURIAE SUPPORTING DISMISSAL

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QUESTIONS PRESENTED

1. Whether dividends paid to appellants on their shares of Federal Home Loan Bank stock are exempt from state income taxation under Section 13 of the Federal Home Loan Bank Act, 12 U.S.C. 1433.

2. Whether dividends paid to appellants on their shares of Federal Home Loan Bank stock are exempt from state income taxation under Section 3701 of the Revised Statutes, 31 U.S.C. 742.

TABLE OF CONTENTS

Page

Opinions below 1

Jurisdiction 1

Statutory provisions involved 3

Statement 3

Argument 5

Conclusion 11

TABLE OF AUTHORITIES

Cases:

Ayer v. *Commissioner*, 12 B.T.A. 284 7

First Federal Savings & Loan Ass'n v. *Department of Revenue*, 654 P.2d 496 9

First Federal Savings & Loan Ass'n v. *Tax Commissioner*, 437 U.S. 255 6

Laurens Federal Savings & Loan Ass'n v. *South Carolina Tax Commission*, 365 U.S. 517 7

Miller v. *Milwaukee*, 272 U.S. 713 7

Pittman v. *Homeowners' Loan Corp.*, 308 U.S. 21 7

Smith v. *Davis*, 323 U.S. 111 9-10

Weston v. *City Council* 27 U.S. (2 Pet.) 449 10

Statutes and regulations:

Act of Feb. 25, 1862, ch. 33, Section 2, 12 Stat. 345 10

Page

Statutes and regulations—Continued:

Act of Sept. 6, 1966, Pub. L. No. 89-554, Section 8(a), 80 Stat. 648 8

Act of Dec. 10, 1971, Pub. L. No. 92-181, Section 5.26(a), 85 Stat. 624 7

Federal Farm Loan Act, 12 U.S.C. (1970 ed.) 931 7

Federal Home Loan Bank Act, 12 U.S.C. (& Supp. V) 1421 *et seq.*:

- Section 2(4), 12 U.S.C. 1422(4) 3
- Section 3, 12 U.S.C. 1423 3
- Section 4, 12 U.S.C. 1424 3
- Section 6(c), 12 U.S.C. 1426(c) 3
- Section 6(c)(2)(ii), 12 U.S.C. (Supp. V) 1426(c)(2)(ii) 4
- Section 6(k), 12 U.S.C. 1426(k) 4
- Sections 9-13, 12 U.S.C. (& Supp. V) 1429-1433 3
- Section 10(c), 12 U.S.C. 1430(c) 4
- Section 13, 12 U.S.C. 1433 ..... 3, 4, 5, 6, 8, 9
- Section 16, 12 U.S.C. 1436 4
- Section 17(a), 12 U.S.C. 1437(a) 3

Federal Reserve Act, 12 U.S.C. 531 7

Home Owners' Loan Act of 1933, ch. 64, 48 Stat. 128, 12 U.S.C. 1461 *et seq.*:

- Section 4(c), 48 Stat. 129 8
- Section 5(h), 48 Stat. 133 (12 U.S.C. 1464(h)) 3, 5, 6

Public Debt of 1942, 31 U.S.C. 742(a) 3, 8

Page

Statutes and regulations—Continued:

Rev. Stat. 3701 (1878 ed.)
(31 U.S.C. 742) 3, 5, 6, 9, 10

12 U.S.C. 2055 7

Treasury Regulations on Income Tax (1954 Code)
(26 C.F.R.):

Section 1.103-2(a) 7, 8
Section 1.312-6(b) 7

Treas. Reg. 118, § 39.22(b)(4)-2
(1939 Code) 8

Miscellaneous:

Cong. Globe, 37th Cong., 2d Sess. (1862):

p. 615 10
pp. 763-765 10
pp. 775-780 10
pp. 889-902 10

1 J. Mertens, *Law of Federal Income Taxation*
(1981) 7

S. Rep. No. 1173, 77th Cong., 2d Sess.
(1943) 8

In the Supreme Court of the United States

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SOONER FEDERAL SAVINGS AND LOAN ASSOCIATION, KAY COUNTY FEDERAL SAVINGS AND LOAN ASSOCIATION, AND FIRST FEDERAL SAVINGS AND LOAN ASSOCIATION OF LAWTON, APPELLANTS

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This brief is submitted in response to the Court's invitation to the Solicitor General to express the views of the United States.

OPINIONS BELOW

The order of the Oklahoma Tax Commission (J.S. App. 11-A to 15-A) and the opinion of the Supreme Court of the State of Oklahoma (J.S. App. 1-A to 10-A) are not officially reported.

JURISDICTION

The jurisdiction of this Court is invoked by appellants (J.S. 3) under 28 U.S.C. 1257(2), which provides for review of final judgments of the highest court of a state in this Court by appeal "where is drawn in question the validity of

a statute of any state on the ground of its being repugnant to the * * * laws of the United States, and the decision is in favor of its validity." See *First Federal Savings & Loan Ass'n* v. *Tax Commission*, 437 U.S. 255 (1978); *Reconstruction Finance Corp.* v. *Beaver County*, 328 U.S. 204, 206-207 (1946).

The judgment of the Supreme Court of Oklahoma in favor of the validity of statutes of the State of Oklahoma, the validity of which as applied was drawn in question on the ground of repugnance to the laws of the United States, was entered on October 5, 1982. The notice of appeal to this Court was filed on October 14, 1982 (J.S. 2-3; J.S. App. 16-A to 17-A). The jurisdictional statement was filed on November 29, 1982. The jurisdiction of this Court is invoked under 28 U.S.C. 1257(a).[1]

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[1]Appellees argue (Mot. to Dis. 2-4) that review of the decision below can only be sought by writ of certiorari because appellants failed to attack the validity of a state statute within the meaning of 28 U.S.C. 1257(2). In appellees' view, the Oklahoma Tax Commission's order was an adjudicatory order and not a "statute" under 28 U.S.C. 1257(2). But it is plain that "the jurisdictional provision uses the words 'a statute of any State' in their larger sense and is not intended to make a distinction between acts of a state legislature and other exertions of the State's law-making power, but rather to include every act legislative in character to which the State gives its sanction" *King Manufacturing Co.* v. *City Council*, 277 U.S. 100, 104-105 (1928), quoted in *Lathrop* v. *Donohue*, 367 U.S. 820, 824 (1961) (plurality opinion). Here, appellants argue that the Oklahoma tax statutes are repugnant to their claimed federal statutory right to tax exemption from state tax on the dividends they received on Federal Home Loan Bank stock, and both the Oklahoma Tax Commission and the Supreme Court of Oklahoma ruled in favor of the validity of the state statutes as applied. Like the orders integrating the Bar in Wisconsin considered by the Court in *Lathrop* v. *Donohue*, *supra*, this ruling below necessarily applies to every similarly situated savings and loan association in Oklahoma and accordingly "ha[s] the characteristics of legislation" (367 U.S. at 827). The appeal is therefore cognizable under Section 1257(2). See also *Dahnke-Walker Milling Co.* v. *Bondurant*, 257 U.S. 282 (1921); *Bantam Books, Inc.* v. *Sullivan*, 372 U.S. 58, 61 n.3 (1963); *Cohen* v. *California*, 403 U.S. 15, 17-18 (1971).

STATUTORY PROVISIONS INVOLVED

The relevant portions of the Federal Home Loan Bank Act, Section 13, 12 U.S.C. 1433; the Home Owners' Loan Act of 1933, Section 5(h), 12 U.S.C. 1464(h); the Rev. Stat. 3701 (1878 ed.), (31 U.S.C. 742); and the Public Debt Act of 1942, 31 U.S.C. 742(a), are set forth in J.S. App. 35-A to 36-A, 39A.

STATEMENT

Appellants are federal savings and loan associations (J.S. App. 2-A). They are chartered and regulated by the Federal Home Loan Bank Board, an independent federal agency created by Congress in 1932 and invested with authority to supervise and regulate, *inter alia,* the Federal Home Loan Bank System. Section 17a, Federal Home Loan Bank Act, 12 U.S.C. 1437(a). That bank system is comprised of 12 regional banks (12 U.S.C. 1423) and was created by Congress to meet the needs of the housing market in the United States by furnishing, at favorable rates, credit facilities for savings and loan associations and other eligible member financial institutions (J.S. App. 2-A to 3-A). See also 12 U.S.C. (& Supp. V) 1429-1433.

As a condition of membership in the bank system, appellants were required to own shares of stock (the amount of which was established according to a formula established by Congress) in one of the regional Federal Home Loan Banks. Sections 2(4), 4 and 6(c), Federal Home Loan Bank Act, 12 U.S.C. (& Supp. V) 1422(4), 1424, 1426(c). "The original stock subscription of each institution eligible to become a member * * * [is] an amount equal to 1 per centum of the subscriber's aggregate unpaid loan principal, but not less than $500." Section 6(c), Federal Home Loan Bank Act, 12 U.S.C. 1426(c). In order to obtain advances

from a Federal Home Loan Bank, member institutions must purchase additional shares of stock above and beyond that which is required as a condition of membership. Section 10(c), Federal Home Loan Bank Act, 12 U.S.C. 1430(c). The amount of such additional stock ownership is directly related to the amount of advances a member institution obtains from a Federal Home Loan Bank (Sections 6(c)(2)(ii) and 10(c), Federal Home Loan Bank Act, 12 U.S.C. (& Supp. V) 1426(c)(2)(ii) and 1430(c); J.S. App. 2-A to 3-A.

All shares of stock in the bank system are entitled to share in dividend distributions without preference. Section 6(k), Federal Home Loan Bank Act, 12 U.S.C. 1426(k). Such dividends are paid out of the net earnings remaining after providing for all reserves and charge-offs required by law. Section 16, Federal Home Loan Bank Act, 12 U.S.C. 1436. Appellants reported and paid Oklahoma corporation income taxes for the years 1972, 1973 and 1974 in the aggregate amount of $13,802.12 on the dividends on their shares of Federal Home Loan Bank stock (J.S. App. 2-A).

Appellants subsequently claimed that the dividends from their Federal Home Loan Bank stock were not subject to state income tax. In their claims for refund of these taxes, appellants claimed that the dividends paid on their shares of Federal Home Loan Bank stock were exempt from state tax under Section 13, Federal Home Loan Bank Act, 12 U.S.C. 1433, which exempts from state income taxation as to principal and interest all notes, debentures, bonds and other such obligations issued by any Federal Home Loan Bank, and further exempts from state taxation the Federal Home Loan Bank, "including its franchise, its capital, reserves and surpluses, its advances, and its income." Appellants contended that the dividends distributed on the Federal Home

Loan Bank stock were exempt under Section 13 as the net income of the Federal Home Loan Bank. Appellants also claimed exemption for such dividends from state income taxation under Rev. Stat. 3701 (1878 ed.) (31 U.S.C. 742) which exempts from state income taxation all stocks, bonds, Treasury notes and other obligation of the United States, and interest paid on such instruments. Finally, appellants apparently contended that the dividends paid on Federal Home Loan Bank stock were exempt from state taxation as a tax on the stock of federal instrumentalities (J.S. App. 3-A to 4-A, 6-A, 14-A; Mot. to Aff. App. A-1 to A-4).

The Oklahoma Tax Commission held that the dividends received by appellants on their shares of Federal Home Loan Bank stock were not exempt from tax under Section 13, Federal Home Loan Bank Act, and that the Section did not prohibit the taxation of income of federally chartered savings and loan associations. The Tax Commission found that the state income tax imposed on the dividends in question was authorized by Section 5(h), Home Owners' Loan Act of 1933, 12 U.S.C. 1464(h), which provides in pertinent part that "No State * * * shall impose any tax on such associations or their income greater than that imposed by such authority on other similar local mutual or cooperative thrift and home financing institutions" (J.S. App. 14-A). The Supreme Court of the State of Oklahoma affirmed on the same ground (J.S. App. 5-A to 10-A). Neither the Tax Commission nor the Oklahoma Supreme Court addressed appellants' contentions under Rev. Stat. 3701 (1878 ed.) (31 U.S.C. 742).

ARGUMENT

The decision of the Supreme Court of the State of Oklahoma is correct and appellants do not present any substantial federal question warranting plenary review.

Appellants' status as federally chartered savings and loan associations does not exempt them from state income taxation. Section 5(h), Home Owners' Loan Act of 1933, 12 U.S.C. 1464(h); *First Federal Savings & Loan Ass'n* v. *Tax Commission* 437 U.S. 255, 260 (1978). Thus, unless some statutory provision exempts from state income tax the dividends paid on appellants' shares of Federal Home Loan Bank stock, those dividends are subject to the Oklahoma income tax. Appellants claim (J.S. 8-11) that the dividends paid on Federal Home Loan Bank stock are exempt from such tax under Section 13, Federal Home Loan Bank Act, 12 U.S.C. 1433 (J.S. 8-11), and under Rev. Stat. 3701 (1878 ed.) (31 U.S.C. 742) (J.S. 11-14). For the reasons that follow, we submit that neither provision supports the claimed exemption.

1. Section 13 of the Federal Home Loan Bank Act exempts from state taxation the principal and interest of "[a]ny and all notes, debentures, bonds, and other such obligations" issued by any Federal Home Loan Bank. That Section further provides that any such "bank, including its franchise, its capital, reserves, and surplus, its advances, and its income" shall be exempt from state taxation. Nothing in that Section expressly precludes the taxation by Oklahoma of dividends paid on shares of Federal Home Loan Bank stock. Nor are we aware of any legislative history expressly purporting to exempt from state income taxation the dividends paid on such shares of stock. What that Section does is to preclude the state taxation of debt instruments of the Federal Home Loan Banks and the interest paid on such instruments and to preclude the taxation of the Federal Home Loan Banks. When Congress has foreclosed the state taxation of dividends paid on shares of

stock of one of its instrumentalities, it has done so specifically. For example, the capital stock in the Federal Reserve Bank and "the income derived" from such stock is specifically exempt from state income taxation. Federal Reserve Act, 12 U.S.C. 531. Likewise, the dividends on shares of stock held in Federal Land Banks is exempt from state taxation. See Federal Farm Loan Act, Section 26, 12 U.S.C. (1970 ed.) 931 (repealed by the Act of Dec. 10, 1971, Pub. L. No. 92-181, Section 5.26(a), 85 Stat. 624). See also 12 U.S.C. 2055.

Appellants argue (J.S. 8-11) that the dividends on shares of Federal Home Loan Bank stock are exempt under Section 13 because the dividends represent a distribution of the Federal Home Loan Bank's income, which is exempt from state taxation. We disagree. Although the dividends are paid out by the Federal Home Loan Bank from its earnings, we do not believe that they are the income of the Federal Home Loan Bank. Rather, they are the income of the stockholder, viz., appellants. And the stockholder's income is not exempt from state income taxation. Cf. Treasury Regulations on Income Tax (1954 Code) (26 C.F.R.), Section 1.312-6(b); see *Ayer* v. *Commissioner*, 12 B.T.A. 284 (1928); 1 J. Mertens, *Law of Federal Income Taxation*, § 9.32 (1981). Since the Oklahoma tax applies equally to the stockholders of all corporations, this case comes within the general rule that "a corporation is a nonconductor that cuts off connection between dividends to its stockholders and the corporate funds from which the dividends are paid." *Miller* v. *Milwaukee*, 272 U.S. 713, 714 (1927).

Laurens Federal Savings & Loan Ass'n v. *South Carolina Tax Commission*, 365 U.S. 517 (1961), and *Pittman* v. *Home Owners' Loan Corp.*, 308 U.S. 21 (1939), upon which appellants rely (J.S. 10-11), are distinguishable. In *Laurens*, this Court held that a state documentary stamp

tax upon promissory notes executed by a federal savings and loan association to evidence advances it received from a Federal Home Loan Bank violated Section 13 of the Federal Home Loan Bank Act, because it was a tax upon the advance itself of the Federal Home Loan Bank, and therefore specifically exempted from state taxation by Section 13. The fact that the documentary stamp tax was to be paid by the federal savings and loan association and not by the Federal Home Loan Bank was deemed irrelevant. In *Pittman,* the Court ruled that a Maryland stamp tax upon mortages executed by the Home Owners' Loan Corporation violated the virtually identical provision of Section 4(c) of the Home Owners' Loan Act of 1933, ch. 64, 48 Stat. 129 (now repealed by the Act of Sept. 6, 1966, Pub. L. No. 89-554, Section 8(a), 80 Stat. 648). Although the purchase of stock (and perforce an advance) is an integral part of the entire advance mechanism of the Federal Home Loan Bank, we do not believe that a tax on the dividends paid on such stock is comparable to an excise tax on advances of the types considered in *Laurens* and *Pittman.*[2]

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[2]Contrary to appellants' suggestion (J.S. 12), there is no support for their claim of state tax exemption in the legislative history of the Public Debt Act of 1942, 31 U.S.C. 742(a) which removed the tax exempt status for federal tax law purposes (unless otherwise provided in the Internal Revenue Code) of dividends, earnings or other income from shares, certificates, stock or other evidences of ownership issued by the United States or any federal agency or instrumentality thereof. See S. Rep. No. 1173, 77th Cong., 2d Sess. 3 (1943). That Act merely removed specific tax-exempt privileges (from federal taxes) on dividends on shares of stock and other evidences of ownership issued by various agencies and instrumentalities of the United States. No such privilege existed with respect to dividends on shares of Federal Home Loan Bank stock prior to the 1942 Act.

We acknowledge that beginning with Section 39.22(b)(4)-2, Treas. Reg. 118 (1939 Code), and continuing in Section 1.103-2(a), Treasury Regulations on Income Tax (1954 Code) (26 C.F.R.), dividends on shares of Federal Home Loan Bank stock issued prior to March 28, 1942, have been exempt from federal income tax on the ground that

We therefore believe that Section 13 of the Federal Home Loan Bank Act does not prohibit the imposition of a state income tax on the dividends paid on shares of Federal Home Loan Bank stock.

2. Appellants' further reliance (J.S. 11-14) upon Rev. Stat. 3701 (1878 ed.) 31 U.S.C. 742), as a basis for an exemption from the state income tax on the dividends of Federal Home Loan Bank stock is misplaced. That Section exempts from state taxation, with certain inapplicable exceptions, "all stocks, bonds, Treasury notes, and other obligations of the United States" both as to principal and "the interest thereon." That statute grants exemption only to interest-bearing obligations authorized by Congress (*Smith* v. *Davis*, 323 U.S. 111, 118-119 (1944)), not to the shares of stock representing equity ownership in the Federal Home Loan Bank upon which dividends may or may not be paid depending upon the profitability of the Federal Home Loan Bank.

Section 3701 is derived from seven statutory exemptions, six of which were enacted during the Civil War, and the seventh in 1870. See *Smith* v. *Davis*, *supra*, 323 U.S. at 117

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they were exempt prior to the Public Debt Act of 1942 under 12 U.S.C. 1433. Whatever the statutory justification for this statement in the Regulations, it has no controlling effect here for it deals with exemption from federal income tax, not state income tax.

See also *First Federal Savings & Loan Ass'n* v. *Department of Revenue*, 654 P.2d 496 (Mont. 1982). The court's opinion was addressed to "interest income from certain federal obligations" (*id.* at 497) and held such "interest income from the federal obligations indicated" (*id.* at 497) to be exempt from the state income tax pursuant to 31 U.S.C. 742. The table appearing (654 P.2d at 497) in the court's opinion indicates that some $48,000 in dividends on Federal Home Loan Bank stock was included in the $221,000 "interest income" at issue. To the extent that the court was unaware of the heterogeneous nature of the income at issue, its decision is not authoritative for purposes of the questions presented here. To the extent that it was so aware, we believe its decision was erroneous.

n.7, which lists the statutes and quotes the exempting provisions. Those exemption provisions were enacted in statutes authorizing the Secretary of the Treasury to borrow large amounts on the credit of the United States, and had as their purpose to prevent taxes, "which diminish in the slightest degree the market value or the investment attractiveness of obligations issued by the United States in an effort to secure necessary credit." *Smith* v. *Davis, supra,* 323 U.S. at 117.

Of the statutes from which Section 3701 was derived, only the Act of Feb. 25, 1862, ch. 33, Section 2, 12 Stat. 345, used the word "stocks." It provided exemption from state taxation for "all stocks, bonds, and other securities of the United States." The term "stock" was used in the congressional debates to refer to interest-bearing securities of the public debt of the federal government. Cong. Globe, 37th Cong., 2d Sess. 615, 763-765, 775-800, 889-902 (1862). As this Court pointed out in *Smith* v. *Davis, supra,* 323 U.S. at 118 n.8, the exemption provided by the Act of Feb. 25, 1862, embraced " 'simply the public securities, such as are described as the permanent debt of the Government.' Cong. Globe, p. 3184, 38th Cong., 1st Sess." Indeed, in this context the term "stock" was used during the Nineteenth Century to refer to interest-bearing securities of the public debt of the federal government. See the various Acts cited in *Smith* v. *Davis, supra,* 323 U.S. at 115. "The stock it [the Federal Government] issues is the evidence of a debt * * *." *Weston* v. *City Council,* 27 U.S. (2 Pet.) 449, 465 (1829). Accordingly, the term "stock" in Rev. Stat. 3701 (1878 ed.), does not cover dividend-paying shares of Federal Home Loan Bank stock.

CONCLUSION

The appeal should be dismissed for want of a substantial federal question.

Respectfully submitted.

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